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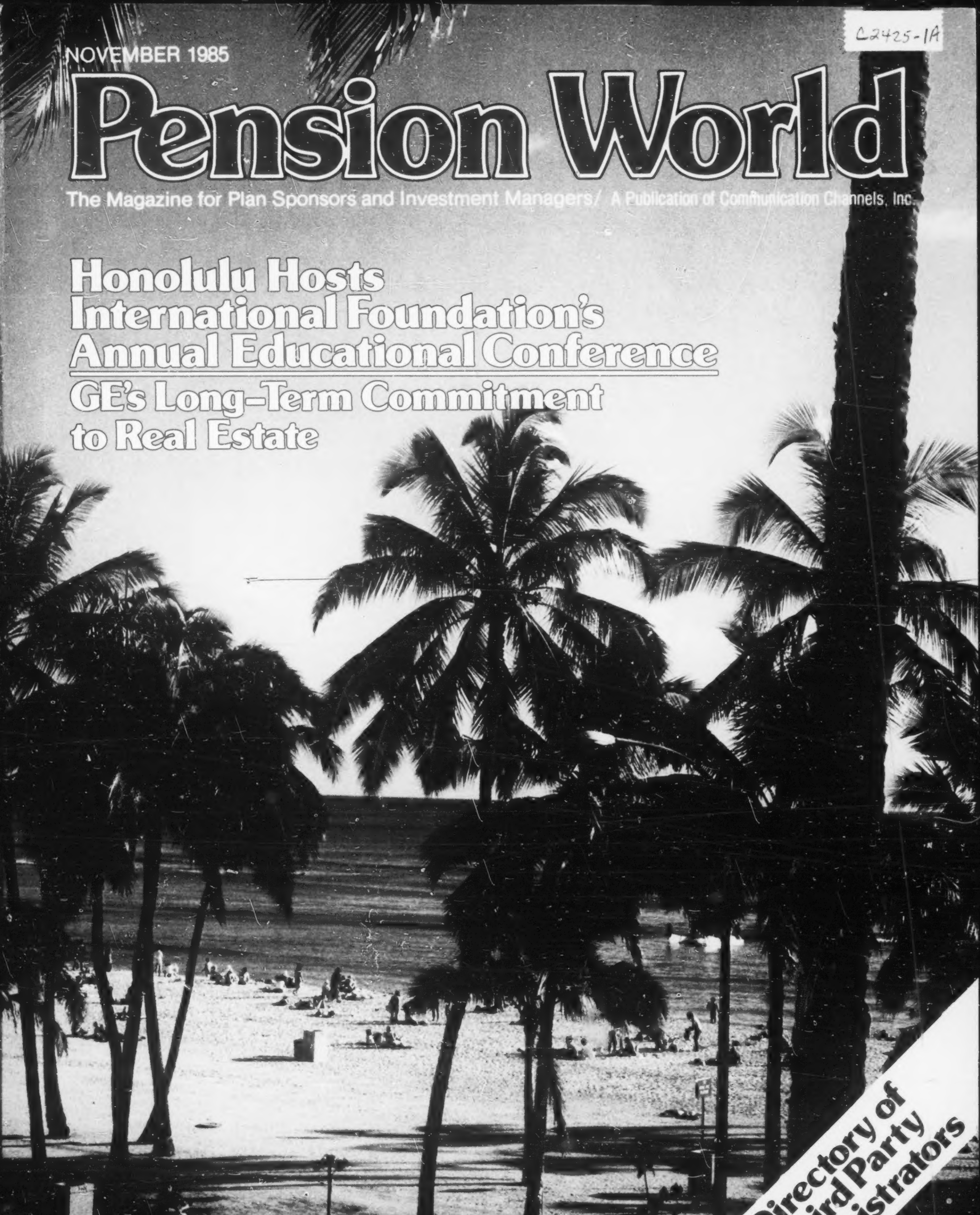
NOVEMBER 1985

Pension World

The Magazine for Plan Sponsors and Investment Managers/ A Publication of Communication Channels, Inc.

Honolulu Hosts International Foundation's Annual Educational Conference

GE's Long-Term Commitment to Real Estate



Directory of Third Party Administrators

Pension World

November 1985
Volume 21 Number 11

The Magazine for Plan Sponsors and Investment Managers/A Publication of Communication Channels, Inc.

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***Cover:* Honolulu is the idyllic setting for this year's Annual Educational Conference of the International Foundation of Employee Benefit Plans. Photo by Charles E. Lloyd. A guest editorial by 1985 Foundation president Henry S. Hunt appears on page 4.**

Pension World is published monthly by Communication Channels, Inc., Tim Gold Blyth, Chairman of the Board; B.J. Kotsher, President; Scott Smith, Secretary; Buford Bryant, Treasurer. Editorial and advertising offices at 6255 Barfield Road, Atlanta, GA 30328. Telephone (404) 256-9800. Telex 4611075COMCHANI. *Pension World* is a registered trademark of Communication Channels, Inc. © 1985 by Communication Channels, Inc. Second class postage paid at Atlanta, GA, and at additional mailing offices. Subscription rates: U.S., 1 year, $41; 2 years, $68; Canada and Mexico, 1 year, $44; Overseas Sea Mail, $51; Overseas Air Mail, $81. Single copies, $3.50. Group rates available. The opinions expressed by authors and contributors to *Pension World* are not necessarily those of the editors or publisher. Articles appearing in *Pension World* may not be reproduced in whole or in part without the express permission of the publisher. Microfilm copies of *Pension World* are available from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106. Postmaster: Please send form 3579 to Circulation Department, *Pension World*, 6255 Barfield Road, Atlanta, GA 30328.

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Update

1985 Real Estate Portfolio Manager Directory

ALEX. BROWN REALTY ADVISORS INC.
225 East Redwood St.
Baltimore, MD 21202
Contact: Christopher W. Kurz, Vice President, (301) 727-3884

Total real estate portfolio assets: $1.008 billion
Total pension fund real estate assets: $584 million
Pension fund real estate clients: 3
Asset breakdown: 100% income-producing property—55.9% office, 6.7% industrial, 36% hotel, 1.4% residential; 96% mortgages; 4% joint venture
Participation offered: Equity oriented debt; participating and/or convertible; and joint venture
Geographic diversification: 6.4% Atlantic, 21.3% Southeast, 11.8% Midwest, 37.8% Southwest, 5.4% West Coast, 17.3% Northwest.
Minimum investment: $10 million
Return on investment: Confidential
Fee: There are three separate accounts and three different confidential fee schedules. Each schedule was customized to suit the client's requirements.

FIRST NATIONAL BANK OF ATLANTA
Trust Department
P.O. Box 4148
Atlanta, GA 30302
Contact: Richard H. Burgin, Vice President, (404) 588-5104

Total real estate portfolio assets: $150 million
Total pension fund real estate assets: $45 million
Pension fund real estate clients: 15
Asset breakdown: 55% income-producing property, 15% mortgages, 30% timber
Participation offered: Timberland is open-end commingled fund; other investments vary
Geographic diversification: Southeast
Minimum investment: $250,000 in Timberland fund
Return on investment: 34% since inception; 8% average annual over four years
Fee: Timberland fund—1.2% per year on market value of timberland; 0.25% per year on cash reserve; fees on other individual investments vary.

KENNEDY ASSOCIATES REAL ESTATE COUNSEL, INC.
2400 Financial Center Building
Seattle, WA 98161
Contact: Michael T. Oliver, Vice President, (206) 623-4739

Total real estate portfolio assets: $617 million
Total pension fund real estate assets: $613 million
Pension fund real estate clients: 78
Asset breakdown: 30.3% income-producing property—64.7% office, 10% industrial, 7.5% retail, 2.5% hotel, 1.8% mixed use, 12.2% office R&D, 1.3% land/condo; 10.9% mortgages; 58.8% hybrid debt.
Participation offered: Units in commingled fund (Multi-Employer/Public Employee Property Trust); individual accounts
Geographic diversification: 15.7% East, 13.7% South, 37.2% Midwest, 33.4% West
Minimum investment: $25 million for individual accounts; no minimum on commingled fund
Return on investment: Separate: 20.44% 1976-1984; latest annual, 22.67% as of 12/31/84
Fee: Separate accounts: annual fee equal to 0.8% of invested capital payable quarterly. Commingled fund: annual fee equal to 1.5% of net assets, payable monthly, charged directly to the commingled fund.

METROPOLITAN LIFE INSURANCE COMPANY
One Madison Avenue
New York, NY 10010
Contact: George Jamgochian, Assistant Vice President, (212) 578-6287

Total real estate portfolio assets: $20+ billion
Total pension fund real estate assets: $445.8 million
Pension fund real estate clients: 44
Asset breakdown: Separate Account RE: 69% income-producing property—76% office, 6% industrial, 1% retail, 13% hotel, 2% land, 2% mixed use; 31% mortgages. Tower Fund: 87% income-producing property—28% office, 2% industrial, 34% retail, 36% R&D. Closed End Series I: 93% income-producing property—100% office. Closed End Series II: 100% income-producing property—55% office, 45% R&D.
Participation offered: Separate Account RE: Open end, joint venture developmental properties or equity real estate investments shared with Metropolitan's General Account. Tower Fund: Open end, wholly-owned real estate investments. Closed End Series I: Closed end, wholly-owned real estate investments. Closed End Series II: Closed end, primarily wholly-owned real estate investments; the fund may also invest in joint ventures offering at least a 50% interest.
Geographic diversification: Separate Account RE: 18% East, 22% Southeast, 9% Southwest, 19% West, 32% Central. Tower Fund: 34% East, 25% South, 33% West, 8% Southwest. Closed End Series I: 41% East, 14% Midwest, 45% West. Closed End Series II: 55% South, 45% West.
Minimum investment: Separate Account RE and Tower Fund: $100,000. Closed End Series I and II: $1 million.
Return on investment: Separate Account RE: 227%, 1/74-6/85; latest annual, 17.7% as of 6/85. Tower Fund: 70%, 2/81-6/85; latest annual, 9.5% as of 6/85. Closed End Series I: 13.8%, 12/83-6/85; latest annual, 8.5% as of 6/85. Closed End Series II: Not yet available.
Fee: Separate Account RE and Tower Fund, 1.25% annual fee, charged quarterly, for the first $10 million of net assets and 1% of net assets over $10 million, plus a flat charge of $1000. Closed End Series I and II: 1.25% of the gross market value of assets at the end of each prior year; one-fourth of this fee will be charged on a quarterly basis.

TRIDENT/MEYER REAL ESTATE ADVISORS
401 North Michigan Ave Suite 525
Chicago, IL 60611
Contact: Stanley W. Campbell, Vice President, (312) 321-1525

Total real estate portfolio assets: $500 million
Total pension fund real estate assets: $180 million
Pension fund real estate clients: 6
Asset breakdown: 13% equity, 87% mortgages—10.4% office, 11.6% office/industrial, 16.6% retail, 61.4% residential
Participation offered: Closed end funds for individual clients with specific purposes, and commingled funds
Geographic diversification: California, Arizona, Illinois, Ohio
Minimum investment: $5 million
Return on investment: Latest annual, 14.78% for 1985
Fee: 1% acquisition, 1% annual advisory and 10% of net profit on disposition

UNITED VIRGINIA BANK
Trust Real Estate Department
P.O. Box 26665
Richmond, VA 23261
Contact: Ronald E. Martin, Assistant Vice President, (804) 782-7259

Total real estate portfolio assets: $200 million
Total pension fund real estate assets: $25 million
Pension fund real estate clients: 172
Asset breakdown: Industrial, retail, land, industrial corporate bonds, short-term investment fund
Participation offered: Commingled open end real estate fund and separate accounts
Geographic diversification: Properties are located in the Sunbelt states
Minimum investment: $1000 per unit for commingled fund and $5 million for separate accounts
Return on investment: Varies
Fee: Commingled fund fees are 1% on real estate assets and ⅜% on liquid assets

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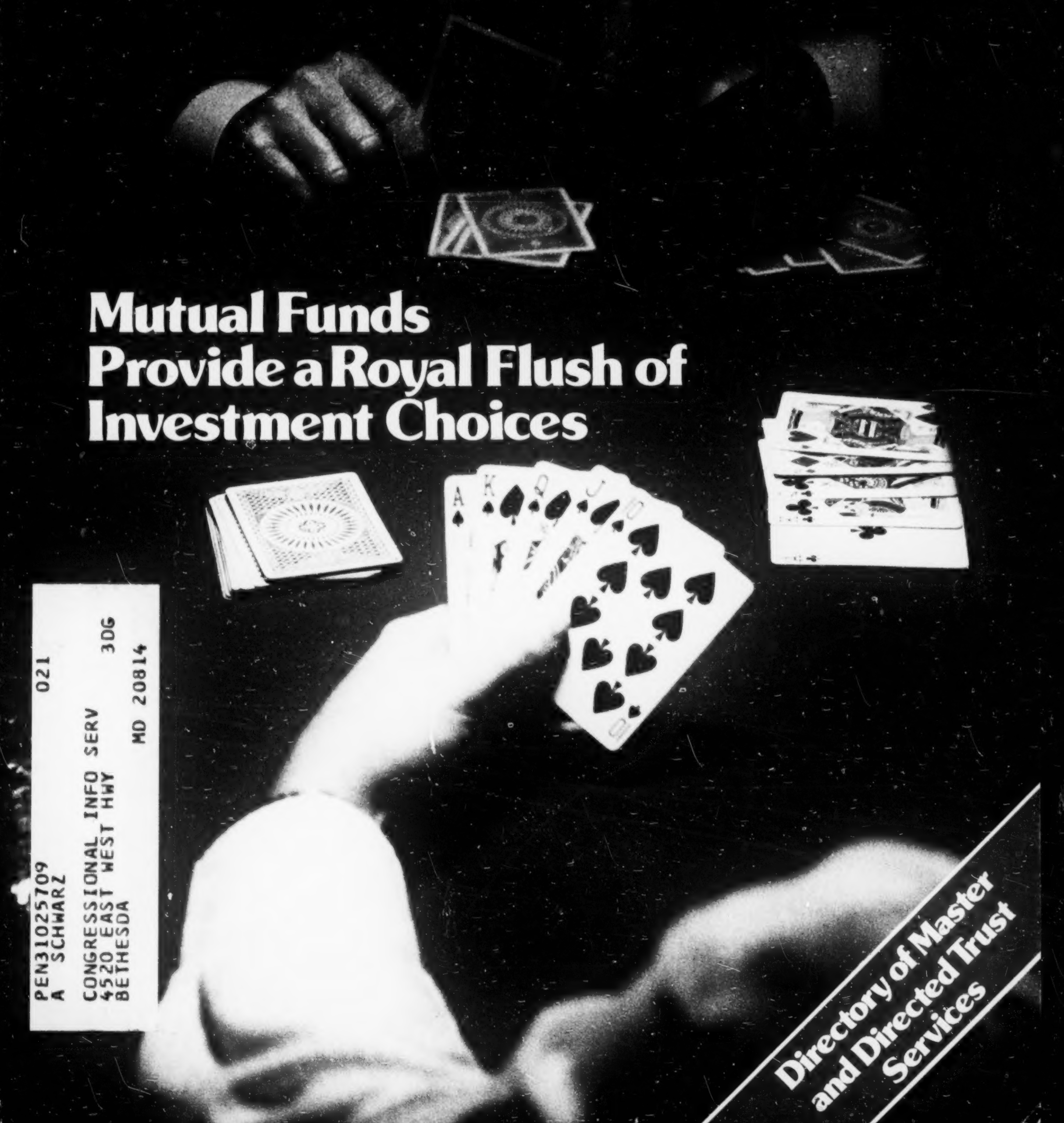

Mutual Funds Provide a Royal Flush of Investment Choices

PEN31025709 021
A SCHWARZ
CONGRESSIONAL INFO SERV 3DG
4520 EAST WEST HWY
BETHESDA MD 20814

Directory of Master and Directed Trust Services

Pension World

December 1985
Volume 21 Number 12

The Magazine for Plan Sponsors and Investment Managers/A Publication of Communication Channels, Inc.

Features

Mutual funds provide a royal flush of investment choices
Ronald Derven
Mutual funds are dealing into the pension marketplace as investment alternatives. 24

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1985 Directory of Master and Directed Trust Services
Compiled by Pension World *staff*
This directory lists 76 institutions, their master trust assets and the services they offer. 57

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Cover: **Mutual funds are dealing into the institutional marketplace with a variety of investment choices. Photo by Kathleen N. Crighton. Ronald Derven's story on trends in mutual funds begins on page 24.**

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1985 Directory of Master and Directed Trust Services

The following *Pension World* Directory is a listing of firms indicating that they offer master and/or directed trusts. It is not an exhaustive list, but rather an identification of the firms that responded in full to *Pension World's* questionnaire.

During September 1985, a questionnaire was mailed to 400 U.S. banks and trust companies. Of the responses received, 76 indicated that they offer master and/or directed trusts.

Master Trust continues to be defined in individual ways by the banks and trust companies offering this service. A technical definition, according to several authorities in the corporate trust industry, is a trust in which *multiple* plans of the same company control or share investment experience under *one trust document.* In working terms, however, some of the definitions used for master trust include: 1) an arrangement under one trust agreement that includes multiple money managers, one of which may or may not be the trustee; 2) a pooling of one sponsor's assets, which may include multiple managers and *one* or more plans, under one trust document; or 3) a pooling of directed trusts.

Similarly, several different definitions are given to the term *directed trust.* The general definition is a trust under which the trustee has less than full managerial authority of the plan sponsor's assets. However, the term is often used synonymously with *directed portfolio,* in which a manager has the authority to direct only those investments within the particular portion of assets under his direct control; and it is sometimes associated with *general trust,* in which a separate trust agreement is written for that portion of assets under the manager's control.

Figures gleaned in the following survey are not always comparable, although *Pension World* has taken every precaution to present these data in their most accurate form. All information in the directory was provided by the banks and trust companies listed. *Pension World* appreciates the efforts of those who completed and returned the questionnaires and hopes that each year's directory will continue to be more comprehensive.

AMERICAN NATIONAL BANK & TRUST COMPANY
5th & Minnesota Streets
St. Paul, MN 55101
Contact: William E. Burmeister, assistant vice president, (612) 298-6274

Number of separate master trust clients: 0
Number of directed trust clients: 8
Master trust assets: 0
Directed trust assets: $30.5 million
Custodial employee benefit assets: $17.5 million
Total employee benefit assets: $105.5 million
Number of separate portfolios: 16
Average number of accounts per account supervisor: 80
Average number of portfolios per investment manager contact: 40
Accounting system utilized: Contractual settlement date
Fail float credit provided: No
Short-term instruments used: Not provided
Date short-term interest credited: 1st business day following month end
Timeliness of reporting package: 10th of month following month end
Services provided: Performance measurement, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Payment date, credited upon receipt
Fee structure: Based on combination of asset value and individual services

AMERITRUST COMPANY
900 Euclid Avenue
Cleveland, OH 44115-1461
Contact: Gary W. Queen, senior vice president, (216) 687-4089

Number of separate master trust clients: 35
Number of directed trust clients: 21
Master trust assets: $4.174 billion
Directed trust assets: $410 million
Custodial employee benefit assets: 0
Total employee benefit assets: $8.4 billion
Number of separate portfolios: 120
Average number of accounts per account supervisor: 7
Average number of portfolios per investment manager contact: 17
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: No
Short-term instruments used: Short-term fund, variable demand notes, CDs, T-bills, Eurodollars, commercial paper, financial reserve fund
Date short-term interest credited: Payable date
Timeliness of reporting package: 3 - 5 business days after month end.
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, real estate, TUCS, AmeriScan (on-line client inquiry)
Policy for crediting dividends and interest: Automatically credited to account on payable date and available for investment on that date as well
Fee structure: Based on combination of asset value and individual services

BANK OF AMERICA NT & SA
555 California Street
San Francisco, CA 94104
Contact: John P. Sheehy, senior vice president, (415) 622-9568

Number of separate master trust clients: 41
Number of directed trust clients: 450
Master trust assets: $13.2 billion
Directed trust assets: $17.5 billion
Custodial employee benefit assets: N/A
Total employee benefit assets: $20.3 billion
Number of separate portfolios: 2600
Average number of accounts per account supervisor: 3
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Trade date (full accrual), contractual settlement date with pending adjustment, contractual settlement date
Fail float credit provided: It can be
Short-term instruments used: Short-term investment fund (STIF)
Date short-term interest credited: First day of following month
Timeliness of reporting package: 5-10 business days for monthly and quarterly reports; 20-30 business days for annual reports.
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, global custody
Policy for crediting dividends and interest: On payable date; credited to STIF
Fee structure: Based on combination of asset value and individual services

THE BANK OF NEW YORK
48 Wall Street
New York, NY 10015
Contact: Robert Darbee, vice president, (212) 530-1354

Number of separate master trust clients: 69
Number of directed trust clients: Not reported
Master trust assets: $19.5 billion
Directed trust assets: Not reported
Custodial employee benefit assets: $9.7 billion
Total employee benefit assets: $29.2 billion
Number of separate portfolios: Not reported
Average number of accounts per account supervisor: 5-10
Average number of portfolios per investment manager contact: Not reported
Accounting system utilized: Trade date (full accrual), contractual settlement date with pending adjustment, contractual settlement date, actual delivery date
Fail float credit provided: Yes
Short-term instruments used: STIF, domestic and foreign Master notes
Date short-term interest credited: Daily
Timeliness of reporting package: 2-5 days
Services provided: Performance measurement, portfolio analysis, portfolio review, securities lending, ERISA disclosure assistance, benefit disbursement, market inventory fund, beneficial interest reporting system, global custody, FIRST (on-line reporting system), dial-in, options/futures, administration
Policy for crediting dividends and interest: Fed Funds on payable date
Fee structure: Based on combination of asset value and individual services

BANK OF OKLAHOMA, N.A.
P.O. Box 2300
Tulsa, OK 74192
Contact: James W. Morris, vice president & trust officer, (918) 588-6448

Number of separate master trust clients: 2
Number of directed trust clients: 23
Master trust assets: $178.9 million
Directed trust assets: $478.5 million
Custodial employee benefit assets: 0
Total employee benefit assets: $1.3 billion
Number of separate portfolios: 103
Average number of accounts per account supervisor: 5
Average number of portfolios per investment manager contact: Not provided
Accounting system utilized: Trade date (full accrual), contractual settlement date
Fail float credit provided: No. Accounts are credited on contractual settlement date regardless of trade status
Short-term instruments used: Internally managed as well as externally provided
Date short-term interest credited: First business day after close of month
Timeliness of reporting package: 10-12 days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, cash sweep programs, on-line terminal at client facility, custom reports
Policy for crediting dividends and interest: On payable date; credit to account through DTC network
Fee structure: Based on combination of asset value and individual services

BANK ONE, DAYTON, N.A.
Kettering Tower
Dayton, OH 45401
Contact: Donald Middendorf, vice president, (513) 449-8659

Number of separate master trust clients: 7
Number of directed trust clients: 23
Master trust assets: $338 million
Directed trust assets: $328 million
Custodial employee benefit assets: $40 million
Total employee benefit assets: $500 million
Number of separate portfolios: 70
Average number of accounts per account supervisor: 20
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: Yes - master trust only
Short-term instruments used: Commercial paper, T-bills, proprietary open-end investment companies
Date short-term interest credited: Month end
Timeliness of reporting package: Interim reports, 3-5 business days; annual reports: 7-25 business days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, zero benefit disbursement for Master Trust, automatic daily sweep of funds in excess of $1.00, investment management
Policy for crediting dividends and interest: On payable date with funds collected, governments, agencies, commercial paper, STIF, clearing-house funds and all other issues
Fee structure: Based on combination of asset value and individual services

BANKERS TRUST COMPANY
280 Park Avenue
New York, NY 10015
Contact: Carter P. Reynolds, vice president, (212) 850-2089

Number of separate master trust clients: 117
Number of directed trust clients: 114

Master trust assets: $63.6 billion
Directed trust assets: $1.6 billion
Custodial employee benefit assets: $10.3 billion
Total employee benefit assets: $106.6 billion
Number of separate portfolios: 1,244
Average number of accounts per account supervisor: 12
Average number of portfolios per investment manager contact: 80
Accounting system utilized: Trade date (full accrual), contractual settlement date with pending adjustment, contractual settlement date, actual delivery date
Fail float credit provided: Yes; fully auditable on net security purchase fails
Short-term instruments used: Master Notes and Commercial Paper of the major finance companies, Certificates of Deposit of major U.S. money-center banks, Euro-dollar C.D.s and Time Deposits issued by these same banks, Certificates of Deposit issued by major European and Japanese banks from their New York agencies, Repurchase Agreements collateralized by U.S. Treasury or Federal Agency obligations, Repurchase Agreements collateralized by the Canadian or foreign issuers mentioned above and Banker's Acceptances
Date short-term interest credited: 1st business day of each month
Timeliness of reporting package: 3-5 business days after close of reporting period
Services provided: performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, cash management, global custody, remote on-line access, consulting, active and passive investment services, cash projection, customized reporting, advisor services, options and futures processing, tax lot accounting and performance attribution
Policy for crediting dividends and interest: On payable date in Federal funds
Fee structure: Based on combination of asset value and individual services

BISHOP TRUST COMPANY, LTD.
P.O. Box 2390
Honolulu, HI 96804
Contact: Daniel P. Zaehring, vice president & manager, employee benefits, (808) 523-2275

Number of separate master trust clients: 53
Number of directed trust clients: 190
Master trust assets: $47 million
Directed trust assets: $200 million
Custodial employee benefit assets: $200 million
Total employee benefit assets: $260 million
Number of separate portfolios: 263
Average number of accounts per account supervisor: 15 master — 40 directed
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: No
Short-term instruments used: Registered money market fund, T-bills, CD's, commercial paper
Date short-term interest credited: Accrued daily, paid on 2nd working day of following month
Timeliness of reporting package: 3 working days transaction; 10 working days asset valuation and projections
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, plan administrator consulting and design
Policy for crediting dividends and interest: Pay date + 1 with good funds
Fee structure: Based on combination of asset value and individual services

BOSTON SAFE DEPOSIT AND TRUST COMPANY
One Boston Place
Boston, MA 02106
Contact: John R. Snow, vice president, (617) 722-6970

Number of separate master trust clients: 35
Number of directed trust clients: 236
Master trust assets: $22.385 billion
Directed trust assets: $802 million
Custodial employee benefit assets: $6.670 billion (15 clients)
Total employee benefit assets: $29.857 billion
Number of separate portfolio: 486
Average number of accounts per account supervisor: 4
Average number of portfolios per investment manager contact: 11
Accounting system utilized: Trade date (full accural); also maintain cash basis accounting system
Fail float credit provided: Yes, if Boston Safe is responsible for fail. Cash is transferred on actual settlement date for all trades
Short-term instruments used: STIF, Reserve Deposit Account, the Boston Company Cash Management Fund
Date short-term interest credited: Accrued daily and credited on the 3rd business day of the following month
Timeliness of reporting package: 5 business days following period-end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund, online access, global custody, options & futures processing, 401(k) capabilities, asset allocation, manager monitoring, consulting services
Policy for crediting dividends and interest: Payable date for Fed Funds; next business day following payable date for clearinghouse funds.
Fee structure: Based on combination of asset value and individual services

CALIFORNIA FIRST BANK
530 "B" Street Box 109
San Diego, CA 92112
Contact: Richard H. Davis, vice president—marketing/product development, (619) 230-3100

Number of separate master trust clients: 0
Number of directed trust clients: N/A
Master trust assets: N/A
Directed trust and custodial employee benefit assets: $1 million
Total employee benefit assets: $700,000 (excluding investment management subsidiary)
Number of separate portfolio: N/A
Average number of accounts per account supervisor: 90
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Trade date only
Fail float credit provided: No
Short-term instruments used: Yes
Date short-term interest credited: Accrued daily/credited month end
Timeliness of reporting package: Normally by 10th of month
Service provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, International Fund, Aggressive Equity Fund
Policy for crediting dividends and interest: On payable date; direct credit to account
Fee structure: Based on combination of asset value and individual services

CENTERRE TRUST COMPANY OF ST. LOUIS
510 Locust Street
St. Louis, MO 63101
Contact: Richard W. Hibbs, vice president, (314) 436-9132

Number of separate master trust clients: 10
Number of directed trust clients: Not available

Retirement Plan Actuary or Consultant Career Opportunity

Santa Barbara firm has position available for an actuary or consultant experienced in plan design, plan administration and plan asset reconciliation. Investment knowledge desirable. Excellent compensation.

Contact: John O'Scanlon, Pres.

Certified Pension Consultants, Inc.
1129 B State St., Suite 5
Santa Barbara, CA 93101
805-963-6837

— No Insurance or Investment Products Sold —

Master trust assets: $2.019 billion
Directed trust assets: $346 million
Custodial employee benefit assets: $756 million
Total employee benefit assets: $2.351 billion
Number of separate portfolio: N/A
Average number of accounts per account supervisor: N/A
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Trade date (full accrual), contractual settlement date with pending adjustment, contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: In-house STIF
Date short-term interest credited: 2nd day following month end
Timeliness of reporting package: 5-7 working days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund
Policy for crediting dividends and interest: On payable date; computer system credit for immediate investment
Fee structure: Based on combination of asset value and individual services

CHASE LINCOLN FIRST BANK

1 Lincoln First Square—6th Floor
Rochester, NY 14643
Contact: Stephen M. Chamberlain, vice president and sales manager, (716) 258-5250

Number of separate master trust clients: 5
Number of directed trust clients: 50
Master trust assets: $728 million
Directed trust assets: $350 million
Custodial employee benefit assets: $835 million
Total employee benefit assets: $300 million
Number of separate portfolio: N/A
Average number of accounts per account supervisor: N/A
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: N/A
Fail float credit provided: N/A
Short-term instruments used: N/A
Date short-term interest credited: N/A
Timeliness of reporting package: N/A
Services Provided: N/A
Policy for crediting dividends and interest: N/A
Fee structure: Based on asset value only

THE CHASE MANHATTAN BANK, N.A.

Pension Trust Financial Services
1211 Avenue of the Americas—33rd Floor
New York, NY 10036
Contact: John A. Sweeney, vice president (212) 730-3008

Number of separate master trust clients: 95
Number of directed trust clients: 200
Master trust assets: 101 Billion
Directed trust assets: $16 Billion
Custodial employee benefit assets: $15 Billion
Total employee benefit assets: $132 Billion
Number of separate portfolios: 1200
Average number of accounts per account supervisor: 10
Average number of portfolios per investment manager contact: 35
Accounting system utilized: Trade date (full accrual), contractual settlement date with pending adjustment, contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: Domestic STIF, international STIF, master note, money market
Date short-term interest credited: Month end
Timeliness of reporting package: Monthly/quarterly statements—7 business days after period end. Annual statement—30 to 45 business days after year-end
Services provided: Performance measurement, portfolio analysis, portfolio review, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund, cash management, global custody, consulting, on-line accounting, comparative performance evaluation
Policy for crediting dividends and interest: Payable date; interest is Fed funds, dividends is clearinghouse funds
Fee structure: Based on combination of asset value and individual services

CITIBANK, N.A.

153 East 53rd Street
New York, NY 10021
Contact: Gregory J. di Pretoro, vice president, (212) 559-1523

Number of separate master trust clients: 34
Number of directed trust clients: 83
Master trust assets: $7.665 billion
Directed trust assets: $9.446 billion
Custodial employee benefit assets: $35.470 billion
Total employee benefit assets: $52.581 billion
Number of separate portfolio: 630
Average number of accounts per account supervisor: 9 Relationships
Average number of portfolios per investment manager contact: 25
Accounting system utilized: Trade date (full accrual), contractual settlement date, actual delivery date
Fail float credit provided: Yes
Short-term instruments used: Citicorp Liquid Reserve Fund, short-term investment fund, demand notes
Date short-term interest credited: Mid-month and end of month
Timeliness of reporting package: 5-7 business days following receipt of all information
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, global custody, Citicorp Portfolio Analyst on-line flexible reporting and graphics
Policy for crediting dividends and interest: Payable date for Fed funds; payable date plus one for clearinghouse funds; credited in good funds immediately available for reinvestment
Fee structure: Based on individual services performed

THE CITIZENS AND SOUTHERN NATIONAL BANK

P.O. Box 4114
Atlanta, GA 30302
Contact: Edgar R. Smith, vice president; marketing, (404) 897-3083

Number of separate master trust clients: 20
Number of directed trust clients: 95
Master trust assets: $800 million
Directed trust assets: $3.2 billion
Custodial employee benefit assets: $3 billion
Total employee benefit assets: $7 billion
Number of separate portfolio: 410
Average number of accounts per account supervisor: 125
Average number of portfolios per investment manager contact: 12
Accounting system utilized: Trade date, contractual settlement date with pending adjustment, contractual settlement date, actual delivery date
Fail float credit provided: Yes
Short-term instruments used: Pooled money market fund, Federated, VANS, cash management fund
Date short-term interest credited: Payable date
Timeliness of reporting package: 10 working days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Payable date with immediate credit to account
Fee structure: Based on combination of asset value and individual services

CITIZENS UNION NATIONAL BANK & TRUST CO.

P.O. Box 575
Lexington, KY 40586
Contact: Brenda M. Tucker, senior vice president, (606) 259-9500

Number of separate master trust clients: 1
Number of directed trust clients: 3
Master trust assets: $2.4 million
Directed trust assets: $1.8 million
Custodial employee benefit assets: $25.6 million
Total employee benefit assets: $29.8 million
Number of separate portfolio: 19
Average number of accounts per account supervisor: 19
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Not provided
Fail float credit provided: Yes
Short-term instruments used: Federated's Trust for U.S. Treasury Obligations
Date short-term interest credited: 1st business day of month
Timeliness of reporting package: Transaction reports — before end of first week; review — before 10th of month
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund
Policy for crediting dividends and interest: Payable plus 1
Fee structure: Based on combination of asset value and individual services

CITY NATIONAL BANK OF MIAMI

25 West Flagler
Miami, FL 33102
Contact: Richard A. Dorn, (305) 577-7393

Number of separate master trust clients: 2
Number of directed trust clients: 4
Master trust assets: $1 million
Directed trust assets: $20 million
Custodial employee benefit assets: $10 million
Total employee benefit assets: $31 million
Number of separate portfolios: 6
Average number of accounts per account supervisor: 6
Average number of portfolios per investment manager contact: 6
Accounting system utilized: Actual delivery date
Fail float credit provided: No
Short-term instruments used: Money market/commercial paper, Treasuries
Date short-term interest credited: 5th working day beginning of each month

Timeliness of reporting package: Whatever customer wants
Services provided: Portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disburement, market inventory fund
Policy for crediting dividends and interest: On payment day through DTC
Fee structure: Based on combination of asset value and individual services

CONNECTICUT BANK AND TRUST CO.
One Constitution Plaza
Hartford, CT 06115
Contact: David R. Willour, head, employee benefit account management department, (203) 244-5030

Number of separate master trust clients: 16
Number of directed trust clients: 18
Master trust assets: $275 million
Directed trust assets: $150 million
Custodial employee benefit assets: $140 million
Total employee benefit assets: $1.5 billion
Number of separate portfolio: 35
Average number of accounts per account supervisor: 7
Average number of portfolios per investment manager contact: 1.5
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: No
Short-term instruments used: STIF funds, variable interest notes, repurchase agreements, CD's, Federal agencies & U.S. Treasuries
Date short-term interest credited: Last business day of month
Timeliness of reporting package: Cash statements: 3rd business day; all others: 6th—10th business day
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Payable date in cash
Fee structure: Based on combination of asset value and individual services

DOMINION TRUST COMPANY
P.O. Box 13327
Roanoke, VA 24040
Contact: Stephen A. Slovensky, vice president, (703) 563-7857

Number of separate master trust clients: None
Number of directed trust clients: 41
Master trust assets: 0
Directed trust assets: $151 million
Custodial employee benefit assets: $76 million
Total employee benefit assets: $227 million
Number of separate portfolios: 176
Average number of accounts per account supervisor: 25
Average number of portfolios per investment manager contact: 60
Accounting system utilized: Contractual settlement date
Fail float credit provided: No
Short-term instruments used: Temporary Investment Fund, Inc.; trust for short-term Federal securities
Date short-term interest credited: First of month following
Timeliness of reporting package: By 3rd business day following end of accounting period to investment managers; by 15th business day to client
Service provided: Portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Corporate issues—settlement date—clearinghouse funds; government issues—settlement date—Federal funds
Fee structure: Based on combination of asset value and individual services

FIDELITY BANK, N.A.
Broad & Walnut Streets, 3 WSPN
Philadelphia, PA 19109
Contact: Alan T. Yuhas, vice president, (215) 985-8143

Number of separate master trust clients: 3
Number of directed trust clients: 62
Master trust assets: $541 million
Directed trust assets: $691 million
Custodial employee benefit assets: $50 million
Total employee benefit assets: $1.65 billion
Number of separate portfolios: 150
Average number of accounts per account supervisor: 15
Average number of portfolios per investment manager contact: 50
Accounting system utilized: Trade date (full accrual), contractual settlement date, actual delivery date
Fail float credit provided: No
Short-term instruments used: STIF, money market fund, Treasury fund
Date short-term interest credited: First of month
Timeliness of reporting package: 10-20 working days
Services provided: Participant recordkeeping, ER-

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First Chicago Investment Advisors
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Pittsburgh, Pennsylvania

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Brookfield, Wisconsin 53008-0069, (414) 786-6700

ISA disclosure assistance, benefit disbursement

Policy for crediting dividends and interest: Payable date in cash

Fee structure: Based on combination of asset value and individual services

THE FIFTH THIRD BANK

Trust Department #00850/Fifth Third Center
Cincinnati, OH 45263
Contact: Timothy J. Lysaght, development officer, (513) 579-5493

Number of separate master trust clients: 0
Number of directed trust clients: 33
Master trust assets: 0
Directed trust assets: $147 million
Custodial employee benefit assets: $1.239 billion
Total employee benefit assets: $1.386 billion
Number of separate portfolio: 81
Average number of accounts per account supervisor: 15
Average number of portfolios per investment manager contact: 1
Accounting system utilized: Contractual settlement date
Fail float credit provided: No
Short-term instruments used: Master demand notes, T-bills, commercial paper, STIF
Date short-term interest credited: 1st day of month
Timeliness of reporting package: Within ten days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, benefit disbursement
Policy for crediting dividends and interest: Payable date
Fee structure: Based on combination of asset value and individual services

FIRST INTERSTATE BANK OF UTAH, N.A.

P.O. Box 30169
Salt Lake City, UT 84142
Contact: Rod R. Cushing, assistant vice president, (801) 350-7118

Number of separate master trust clients: 30
Number of directed trust clients: 25
Master trust assets: $250 million
Directed trust assets: $150 million
Custodial employee benefit assets: $100 million
Total employee benefit assets: $600 million
Number of separate portfolio: 80
Average number of accounts per account supervisor: 50
Average number of portfolios per investment manager contact: 50
Accounting system utilized: Contractual settlement date
Fail float credit provided: No
Short-term instrument used: Various STIF Funds
Date short-term interest credited: First
Timeliness of reporting package: 5-10 business days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: On payable date through internal suspense
Fee structure: Based on combination of asset value and individual services

FIRST INTERSTATE BANK OF WASHINGTON, N.A.

P.O. Box 21927
Seattle, WA 98111
Contact: Lawrence T. Divers, vice president and trust officer, (206) 343-8346

Number of separate master trust clients: N/A
Number of directed trust clients: 146
Master trust assets: N/A
Directed trust assets: $408.9 million
Custodial employee benefit assets: $791.1 million
Total employee benefit assets: $1.2 billion
Number of separate portfolio: 146
Average number of accounts per account supervisor: 18
Average number of portfolios per investment manager contact: 18
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: Yes
Short-term instruments used: Federated and First Interstate's own short term investment fund
Date short-term interest credited: Not provided
Timeliness of reporting package: 10 working days after the end of the month
Service provided: Performance measurement, portfolio review, participant recordkeeping, benefit disbursement, investment management, full custodial services, cash management, lockbox processing

FIRST NATIONAL BANK & TRUST COMPANY OF TULSA

P.O. Box One
Tulsa, OK 74193
Contact: Richard A. Moser, vice president and trust officer, (918) 586-5661

Number of separate master trust clients: 10
Number of directed trust clients: 4
Master trust assets: $151.1 million
Directed trust assets: $23.5 million
Custodial employee benefit assets: $541.5 million
Total employee benefit assets: $769.7 million
Number of separate portfolios: 40
Average number of accounts per account supervisor: 50
Average number of portfolios per investment manager contact: 20
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: Yes
Short-term instruments used: Money market funds, CDs, government and commercial paper
Date short-term interest credited: Second business day after month end
Timeliness of reporting package: Tenth business day following period end
Service provided: Portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, asset allocation
Policy for crediting dividends and interest: Payable date in clearinghouse funds
Fee structure: Based on combination of asset value and individual services

THE FIRST NATIONAL BANK OF ATLANTA

2 Peachtree Street, NE
P.O. Box 4148
Atlanta, GA 30302
Contact: Richard H. Burgin, vice president-manager, employee benefit sales, (404) 588-5104

Number of separate master trust clients: 5
Number of directed trust clients: 55
Master trust assets: $1.88 billion
Directed trust assets: $507 million
Custodial employee benefit assets: $613 million
Total employee benefit assets: $3.0 billion
Number of separate portfolio: 150
Average number of accounts per account supervisor: 20
Average number of portfolios per investment manager contact: 50
Accounting system utilized: Contractual settlement date with pending adjustment and full accrual
Fail float credit provided: No
Short-term instruments used: Shearson Temporary Fund B, First Trust money market deposit, various master notes
Date short-term interest credited: First business day of the month following the month in which earned
Timeliness of reporting package: 10 days after period end for statements and portfolio listings; 30 days after period end for a full accounting report package
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, Core Equity Fund
Policy for crediting dividends and interest: Payable date by funds transferred through depositories such as DTC, Bankers Trust and the Federal Reserve
Fee structure: Based on combination of asset value and individual services

FIRST PENNSYLVANIA BANK, N.A.

Packard Building, Third floor
Philadelphia, PA 19072
Contact: James F. McHale, senior vice president (215) 786-7946

Number of separate master trust clients: 14 (also an additional 9 Master Custodial clients)
Number of directed trust clients: Not provided
Master trust assets: $1.4 billion (also an additional $17.1 billion Master Custodial assets)
Directed trust assets: $850 million
Custodial employee benefit assets: $16.5 billion
Total employee benefit assets: $18.0 billion
Number of separate portfolios: N/A
Average number of accounts per account supervisor: N/A
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Trade date (full accrual), contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: Government-secured money market
Policy for crediting dividends and interest: On due date
Fee structure: Based on combination of asset value and individual services
Date short-term interest credited: Daily
Timeliness of reporting package: 10 working days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, global custody
Policy for crediting dividends and interest: Payable date in clearinghouse funds
Fee structure: Based on individual services performed

FIRST SECURITY BANK OF IDAHO, N.A.

P.O. Box 2618
Boise, ID 83701
Contact: Mark A. Simonson, assistant vice president and trust officer, (208) 338-2032

Number of separate master trust clients: 1
Number of directed trust clients: 29
Master trust assets: $35.9 million
Directed trust assets: $42.4 million
Custodial employee benefit assets: $35.6 million
Total employee benefit assets: $210.7 million
Number of separate portfolios: 26

Average number of accounts per account supervisor: 75
Average number of portfolios per investment manager contact: 100
Accounting system utilized: Contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: Money market funds, individual money market instruments
Date short-term interest credited: 3rd business day
Timeliness of reporting package: 5th business day
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, plan design and qualification
Policy for crediting dividends and interest: Payable date through credit to account
Fee structure: Based on combination of asset value and individual services; also transaction charges

FIRST SECURITY BANK OF UTAH, N.A.
P.O. Box 30007
Salt Lake City, UT 84130
Contact: Patricia Richards, vice president and manager, (801) 350-5356

Number of separate master trust clients: 1
Number of directed trust clients: 30
Master trust assets: $107 million
Directed trust assets: $87.9 million
Custodial employee benefit assets: $72.2 million
Total employee benefit assets: $218.7 million
Number of separate portfolios: 34
Average number of accounts per account supervisor: 10
Average number of portfolio per investment manager contact: 11
Accounting system utilized: Contractual settlement date
Fail float credit provided: N/A
Short-term instruments used: Money market fund
Date short-term interest credited: Last day of month
Timeliness of reporting package: Within 9 working days of end of period
Services provided: Portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, index fund
Policy for crediting dividends and interest: Upon receipt of cash
Fee structure: Based on combination of asset value and individual services

FIRST TENNESSEE BANK NATIONAL ASSOCIATION
P.O. Box 84
Memphis, TN 38101
Contact: Nancy McKinnie, vice president, (901) 523-4628

Number of separate master trust clients: 9
Number of directed trust clients: 18
Master trust assets: $410 million
Directed trust assets: $188 million
Custodial employee benefit assets: $45 million
Total employee benefit assets: $1.2 billion
Number of separate portfolios: 92
Average number of accounts per account supervisor: 23
Average number of portfolios per investment manager contact: 4.4
Accounting system utilized: Trade date (full accrual) to be implemented; currently, contractual settlement date with pending adjustment
Fail float credit provided: Yes
Short-term instruments used: Variety of in-house and external money market instruments
Date short-term interest credited: Same day (or compounded daily)
Timeliness of reporting package: 10 days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, asset allocation
Policy for crediting dividends and interest: On payment date in clearinghouse funds
Fee structure: Based on combination of asset value and individual services

FIRST TRUST COMPANY, INC.
(formerly First Trust Company Saint Paul)
W555 First National Bank Building
Saint Paul, MN 55101
Contact: Robert J. Kay, marketing officer, (612) 291-4924

Number of separate master trust clients: 23
Number of directed trust clients: 60
Master trust assets: $2.8 billion
Directed trust assets: $2.0 billion
Custodial employee benefit assets: $600 million
Total employee benefit assets: $6.0 billion
Number of separate portfolio: 85
Average number of accounts per account supervisor: 7
Average number of portfolios per investment manager contact: 3
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: Yes
Short-term instruments used: Short term investment fund, super STIF, Federated
Date short-term interest credited: First of the month
Timeliness of reporting package: Complete accounting 10 business days after end of period
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund, TUCS, option overwriting, Super STIF
Policy for crediting dividends and interest: On payable date; Fed funds on payable date and clearinghouse funds on payable date plus one
Fee structure: Based on combination of asset value and individual services

FIRST TRUST COMPANY OF NORTH DAKOTA
Box 1980
Fargo, ND 58107
Contact: Roger L. Sullivan, senior trust officer, (701) 293-3313

Number of separate master trust clients: 55
Number of directed trust clients: 50
Master trust assets: $185 million
Directed trust assets: $21 million
Custodial employee benefit assets: $15 million
Total employee benefit assets: $221 million
Number of separate portfolios: 51
Average number of accounts per account supervisor: 85
Average number of portfolios per investment manager contact: 55
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: Yes
Short-term instruments used: Time deposit open account and STIF Government Fund
Date short-term interest credited: 30-day cycle—3rd day of month
Timeliness of reporting package: 60-75 days following plan year end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Cash basis and accrual for plan year end
Fee structure: Based on combination of asset value and individual services

FIRST VERMONT BANK & TRUST COMPANY
215 Main Street
Brattleboro, VT 05301
Contact: Donna L. Gilbert, employee benefits administrator, (802) 254-8711

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First National Bank Building
Saint Paul, Minnesota 55101

Robert J. Kay
612/291-4924

Kevin Underkofler
612/291-6238

Number of separate master trust clients: 0
Number of directed trust clients: 3
Master trust assets: 0
Directed trust assets: $6.26 million
Custodial employee benefit assets: 0
Total employee benefit assets: $45 million
Number of separate portfolios: 3
Average number of accounts per account supervisor: N/A
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: N/A
Short-term instruments used: Short-term U.S. Government Securities Fund, Federated
Date short-term interest credited: On receipt
Timeliness of reporting package: 10 days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Interest: payable date; dividends: payable + 1
Fee structure: Based on combination of asset value and individual services

FIRST WISCONSIN TRUST COMPANY

777 E. Wisconsin Avenue
P.O. Box 2054
Milwaukee, WI 53202
Contact: Anthony M. Rood, first vice president, (414) 765-4444

Number of separate master trust clients: 31
Number of directed trust clients: 219
Master trust assets: $1.701 billion
Directed trust assets: $821 million
Custodial employee benefit assets: $1.1 billion
Total employee benefit assets: $1.392 billion
Number of separate portfolios: 810
Average number of accounts per account supervisor: 15
Average number of portfolios per investment manager contact: 44
Accounting system utilized: Trade date with full income accrual
Fail float credit provided: N/A
Short-term instruments used: Short term income fund and variable demand notes
Date short-term interest credited: Fifth business day of month
Timeliness of reporting package: Financial transactions on the second business day of the month; list of assets indicating both cost and market value on the third business day of the month. Complete monthly financial reports for each investment manager account on a fully accrued, trade date basis are available on the eighth to tenth business day of the month.
Services provided: Performance measurement, portfolio analysis, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, bond immunization, bond dedication, fixed income indexing, real estate and technology funds
Policy for crediting dividends and interest: On payment date in good funds
Fee structure: Based on combination of asset value and individual services

FLORIDA NATIONAL BANK

P.O. Box 689
Jacksonville, FL 32201
Contact: Robert E. Mitchell, vice president (904) 359-5300

Number of separate master trust clients: 4
Number of directed trust clients: 3
Master trust assets: $17 million
Directed trust assets: $72 million
Custodial employee benefit assets: $520 million
Total employee benefit assets: $609 million
Number of separate portfolio: 4
Average number of accounts per account supervisor: 4
Average number of portfolios per investment manager contact: Not provided
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: No
Short-term instruments used: Various money market funds
Date short-term interest credited: Third working day of the next month
Timeliness of reporting package: Five to ten working days
Services provided: Portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Dividends—due day + one day, interest same day; in cash
Fee structure: Based on combination of asset value and individual services

THE FOURTH NATIONAL BANK & TRUST CO., WICHITA

P.O. Box 1122
Witchita, KS 67201
Contact: P. C. Woodward, vice president and trust officer, (316) 261-4260

Number of separate master trust clients: 1
Number of directed trust clients: 18
Master trust assets: $62 million
Directed trust assets: $30.2 million
Custodial employee benefit assets: 0
Total employee benefit assets: $299.8 million (11/30/84 Call Report)
Number of separate portfolios: 28
Average number of accounts per account supervisor: 7
Average number of portfolios per investment manager contact: 7
Accounting system utilized: Contractual settlement date
Fail float credit provided: No
Short-term instruments used: Goldman, Sachs Co. Institutional Liquid Assets Prime Obligations Portfolio
Date short-term interest credited: 1st or 2nd of each month
Timeliness of reporting package: All accounting and investment reviews mailed within 30 days following end of cycle
Services provided: Performance measurement, portfolio analysis, portfolio review, benefit disbursement
Policy for crediting dividends and interest: Payable + 1 through direct participation with Depository Trust Company
Fee structure: Based on individual services performed

FULTON BANK

One Penn Square
P.O. Box 4887
Lancaster, PA 17604
Contact: Richard J. Spangler, vice president, (717) 291-2516

Number of separate master trust clients: 0
Number of directed trust clients: 7
Master trust assets: 0
Directed trust assets: $58.7 million
Custodial and trusted employee benefit assets: $82.3 million
Total employee benefit assets: $141.1 million
Number of separate portfolios: 480
Average number of accounts per account supervisor: 120
Average number of portfolios per investment manager contact: 160
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: No
Short-term instruments used: SFS Money Funds—four funds available
Date short-term interest credited: Second business day after month end
Timeliness of reporting package: Seventh business day after account year end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Payable + 2 through accrual method
Fee structure: Based on combination of asset value and individual services

HARRIS TRUST AND SAVINGS BANK

111 West Monroe Street
Chicago, IL 60603
Contact: Walter J. Kowalczyk, vice president, (312) 461-7625

Number of separate master trust clients: 51
Number of directed trust clients: 123
Master trust assets: $26 billion
Directed trust assets: $4 billion
Custodial employee benefit assets: $620 million
Total employee benefit assets: $34 billion
Number of separate portfolios: 690
Average number of accounts per account supervisor: 8
Average number of portfolios per investmment manager contact: 60
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: Yes
Short-term instruments used: STIF, commercial paper, certificates of deposit (domestic & Euro); bankers acceptances, U.S. Government and Agency issues, repurchase agreements and demand notes
Date short-term interest credited: 3rd or 4th business day of the following month
Timeliness of reporting package: Monthly transactions and asset reports—2 to 7 business days; quarterly and annual financial summaries (with ERISA reports)—12 to 15 business days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund, TUCS, options/futures accounting, global custody, on-line accounting and analytics with download capabilities, automated daily sweep of cash, customized cash management
Policy for crediting dividends and interest: On payable date in good funds
Fee structure: Based on combination of asset value and individual services

HERITAGE PULLMAN BANK & TRUST COMPANY

1000 E. 111th St.
Chicago, IL 60628
Contact: S. Z. Kinsman, vice president and trust officer, (312) 785-1000

Number of separate master trust clients: N/A
Number of directed trust clients: 140

Master trust assets: N/A
Directed trust assets: $90 million
Custodial employee benefit assets: $5 million
Total employee benefit assets: $120 million
Number of separate portfolios: 16
Average number of accounts per account supervisor: 115
Average number of portfolios per investment manager contact: 15
Accounting system utilized: Not provided
Fail float credit provided: No
Short-term instruments used: Federated
Date short-term interest credited: 5th day of month
Timeliness of reporting package: Portfolio reviews by 5th day of month; annual reports 2 weeks after receiving data
Services provided: Portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: On payment date through credit to account
Fee structure: Based on combination of asset value and individual services

INDUSTRIAL VALLEY BANK & TRUST COMPANY

1700 Market St.
Philadelphia, PA 19103
Contact: H. Sheppard Millar, assistant vice president and trust officer, (215) 496-4729

Number of separate master trust clients: 0
Number of directed trust clients: 6
Master trust assets: 0
Directed trust assets: $21 million
Custodial employee benefit assets: $91 million
Total employee benefit assets: $329 million
Number of separate portfolios: 6
Average number of accounts per account supervisor: 2
Average number of portfolios per investment manager contact: 2
Accounting system utilized: Contractual settlement date
Fail float credit provided: N/A
Short-term instruments used: Yes—3
Date short-term interest credited: 1st of month
Timeliness of reporting package: Not provided
Services provided: Portfolio review, participant recordkeeping, benefit disbursement
Policy for crediting dividends and interest: Payable through credit to cash
Fee structure: Based on combination of asset value and individual services

THE INTERNATIONAL TRUST COMPANY

Box 75
Royal Bank Plaza, North Tower
Toronto, Ontario M5J 2J2
Contact: Daniel Varanelli, account manager, client services, (416) 865-0515

Number of separate master trust clients: 13
Number of directed trust clients: 18
Master trust assets: $1.098 billion
Directed trust assets: $197.7 million
Custodial employee benefit assets: $553.5 million
Total employee benefit assets: $1.849 billion
Number of separate portfolios: 162
Average number of accounts per account supervisor: 7
Average number of portfolios per investment manager contact: 2
Accounting system utilized: Trade date (full accrual), contractual settlement date
Fail float credit provided: No
Short-term instruments used: Short term investment funds
Date short-term interest credited: Last day of month
Timeliness of reporting package: 8-10th business day after reporting period
Services provided: Performance measurement, portfolio analysis, participant recordkeeping, securities lending, benefit disbursement, index fund, short term investment funds, pooled fund investments
Policy for crediting dividends and interest: On payable date through credit to client's account
Fee structure: Based on combination of asset value and individual services

IRVING TRUST COMPANY

One Wall Street
New York, NY 10011
Contact: Gary L. Davenport, vice president, (212) 487-7980

Number of separate master trust clients: 42
Number of directed trust clients: 192
Master trust assets: $19.7 billion
Directed trust assets: $3.6 billion
Custodial employee benefit assets: $15.5 billion
Total employee benefit assets: $32.8 billion
Number of separate portfolios: 335
Average number of accounts per account supervisor: 10
Average number of portfolios per investment manager contact: 20
Accounting system utilized: Trade date (full accrual), contractual settlement date with pending adjustment
Fail float credit provided: Yes
Short-term instruments used: Irving Trust Collective Short Term Investment Fund, master notes, money market funds
Date short-term interest credited: First of following month
Timeliness of reporting package: Fifth-seventh business day
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund, investment management, global custody, pension consulting services, immunized and dedicated bond portfolios, ESOP, PAYSOP trustee services
Policy for crediting dividends and interest: On payable date in Federal funds
Fee structure: Based on combination of asset value and individual services

LASALLE NATIONAL BANK

135 S. LaSalle St.
Chicago, IL 60690
Contact: James F. Sullivan, executive vice president, (312) 443-2497

Number of separate master trust clients: 10
Number of directed trust clients: 50
Master trust assets: $300 million
Directed trust assets: $150 million
Custodial employee benefit assets: N/A
Total employee benefit assets: $900 million (excluding pure custody)
Number of separate portfolios: 4 per master trust, 10 maximum
Average number of accounts per account supervisor: 40
Average number of portfolios per investment manager contact: 2
Accounting system utilized: Contractual settlement date with pending adjustment, actual delivery date (varies by account)
Fail float credit provided: Optional
Short-term instruments used: STIF
Date short-term interest credited: Second or third workday
Timeliness of reporting package: Varies by client
Services provided: Performance measurement, portfolio analysis, participant recordkeeping, benefit disbursement, six equity and four fixed income investment funds, prototype 401(k) plan
Policy for crediting dividends and interest: Credited on payable date
Fee structure: Based on base fee plus asset value only; based on individual services performed for benefit checks (pension) and participant recordkeeping

M&I MARSHALL & ILSLEY BANK

770 North Water Street
Milwaukee, WI 53201
Contact: Morry L. Birnbaum, vice president, (414) 765-8187

Number of separate master trust clients: 30
Number of directed trust clients: 160
Master trust assets: $2.6 billion
Directed trust assets: $550 million
Custodial employee benefit assets: $1.5 billion
Total employee benefit assets: $2.3 billion
Number of separate portfolios: 600
Average number of accounts per account supervisor: 10
Average number of portfolios per investment manager contact: 15
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: Negotiated
Short-term instruments used: STIF with ACM, T-bills
Date short-term interest credited: Daily
Timeliness of reporting package: 5-7 business days
Services provided: Performance measurement, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: On payable date
Fee structure: Based on combination of asset value and individual services

MANUFACTURERS HANOVER TRUST COMPANY

530 Fifth Avenue—4th Floor
New York, NY 10036
Contact: Renee San Marco, vice president, (212) 819-1580

Number of separate master trust clients: 66 (including master custody)
Number of directed trust clients: 54
Master trust assets: $14.2 billion (as of 10/15/85)
Directed trust assets: $1.3 billion
Custodial employee benefit assets: $21.7 billion
Total employee benefit assets: $37.2 billion
Number of separate portfolios: N/A
Average number of accounts per account supervisor: N/A
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Trade date (full accrual), contractual settlement date with pending adjustment, contractual settlement date, actual delivery date
Fail float credit provided: Yes
Short-term instruments used: STRF
Date short-term interest credited: Accrues daily and is credited once a month
Timeliness of reporting package: Usually 3rd

business day of month
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund
Policy for crediting dividends and interest: On payable date interest and dividend income are automatically credited and available for investment
Fee structure: Based on combination of asset value and individual services

MANUFACTURERS NATIONAL BANK OF DETROIT

100 Renaissance Center, 6th Floor
Detroit, MI 48033
Contact: Robert R. Schoonbeck, senior vice president and senior trust officer, (313) 222-4866

Number of separate master trust clients: 56
Number of directed trust clients: 453
Master trust assets: $12.5 billion
Directed trust assets: $974 million
Custodial employee benefit assets: $4.826 billion
Total employee benefit assets: $18.3 billion
Number of separate portfolios: 70
Average number of accounts per account supervisor: 75
Average number of portfolios per investment manager contact: 75
Accounting system utilized: Contractual settlement date which incorporates a pending trade date accrual schedule, accruing all transactions as of trade date and incorporates accrued transactions in the account value
Fail float credit provided: Yes
Short-term instruments used: Manufacturers Bank's Short Term Fund
Date short-term interest credited: Fifth workday following prior month-end
Timeliness of reporting package: Regular accounting reports and cash and asset statements are available and delivered on fifth workday following the prior month-end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund
Policy for crediting dividends and interest: Dividends and interest are advanced on payable date in Fed funds
Fee structure: Based on combination of asset value and individual services

MARINE MIDLAND BANK, N.A.

250 Park Avenue
New York, NY 10177
Contact: James Esposito, vice president, (212) 503-2723

Number of separate master trust clients: 26
Number of directed trust clients: 70
Master trust assets: $1.5 billion
Directed trust assets: $280 million
Custodial employee benefit assets: $405 million
Total employee benefit assets: $2.185 billion
Number of separate portfolios: 185
Average number of accounts per account supervisor: 40
Average number of portfolios per investment manager contact: 40
Accounting system utilized: Trade date (full accrual), contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: Master notes, money market funds, collective short term investment fund, CD's, C/P, Eurodollar CD's
Date short-term interest credited: First business day of month
Timeliness of reporting package: Five business days for cash accountings and ten business days for accrual accountings
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, plan accountings, cash management, on-line reporting
Policy for crediting dividends and interest: On payable date: precredited to account regardless of nonreceipt of funds
Fee structure: Based on combination of asset value and individual services

MARQUETTE BANK MINNEAPOLIS

90 South Sixth St.
Minneapolis, MN 55419
Contact: David E. Hartle, assistant vice president and trust officer, (612) 341-5951

Number of separate master trust clients: 48
Number of directed trust clients: 11
Master trust assets: $99.6 million
Directed trust assets: $9.85 million
Custodial employee benefit assets: $91.7 million
Total employee benefit assets: $408 million
Number of separate portfolios: 25
Average number of accounts per account supervisor: 100
Average number of portfolios per investment manager contact: Not provided
Accounting system utilized: Contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: In-house, Federated, Fidelity, Shearson/American Express
Date short-term interest credited: 1st of each month
Timeliness of reporting package: Not provided
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: On payable date; automated
Fee structure: Based on combination of asset value and individual services

MARYLAND NATIONAL BANK

10 Light Street
Baltimore, MD 21203
Contact: Gordon R. Boardway, employee benefits trust officer, (301) 244-1443

Number of separate master trust clients: 4
Number of directed trust clients: 86
Master trust assets: $165 million
Directed trust assets: $650 million
Custodial employee benefit assets: $30 million
Total employee benefit assets: $950 million
Number of separate portfolios: 8
Average number of accounts per account supervisor: Not provided
Average number of portfolios per investment manager contact: Not provided
Accounting system utilized: Contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: Commingled short term investment fund consisting primarily of CDs, commercial paper, Treasuries
Date short-term interest credited: Daily
Timeliness of reporting package: As frequently as monthly, within 10 days after the end of the reporting period
Services provided: Performance measurement, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, five commingled trust funds, GIC search, cash management
Policy for crediting dividends and interest: On pay date; credited to cash
Fee structure: Based on combination of asset value and individual services

MELLON BANK

One Mellon Bank Center
Pittsburgh, PA 15258
Contact: Darryl J. Fluhme, vice president, (412) 234-4111

Number of separate master trust clients: 71
Number of directed trust clients: 325
Master trust assets: $46.9 billion
Directed trust assets: $2.8 billion
Custodial employee benefit assets: $4.1 billion
Total employee benefit assets: $60.8 billion
Number of separate portfolios: 1000
Average number of accounts per account supervisor: 7
Average number of portfolios per investment manager contact: 50
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: Yes
Short-term instruments used: Commingled, short-term funds using A-1 and P-1 investments
Date short-term interest credited: Earned daily/credited weekly
Timeliness of reporting package: Monthly, quarterly and annually with monthly statements available 3rd business day following month end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund, international custody, analytical package, online access, options & futures
Policy for crediting dividends and interest: On payable date with clearinghouse funds
Fee structure: Based on combination of asset value and individual services

MICHIGAN NATIONAL BANK

77 Monroe Center
Grand Rapids, MI 49501
Contact: Thomas L. DeFer, vice president (616) 451-7686

Number of separate master trust clients: 2
Number of directed trust clients: 47
Master trust assets: $50 million
Directed trust assets: $79 milion
Custodial employee benefit assets: $96 milion
Total employee benefit assets: $460 million
Number of separate portfolios: 4
Average number of accounts per account supervisor: 4
Average number of portfolios per investment manager contact: 1
Accounting system utilized: Contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: Institutional liquid assets or Trust for Short Term Government Securities
Date short-term interest credited: 2nd business day of the month
Timeliness of reporting package: Monthly—within 5 business days; quarterly, semiannually and annually—20 business days
Services provided: Performance measurement, portfolio analysis, portfolio review, partici-

pant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Payable plus one; credited automatically
Fee structure: Based on combination of asset value and individual services

NATIONAL BANK OF DETROIT
611 Woodward
Detroit, MI 48226
Contact: Clarence E. Kufel, vice president, (313) 225-3900

Number of separate master trust clients: 67
Number of directed trust clients: 27
Master trust assets: $12.1 billion
Directed trust assets: $9.1 billion
Custodial employee benefit assets: $21.2 billion
Total employee benefit assets: $26.4 billion
Number of separate portfolios: 293
Average number of accounts per account supervisor: 10-15
Average number of portfolios per investment manager contact: 10-15
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: Yes
Short-term instruments used: NBD STIF, master notes, repurchase agreements, domestic and Euro-dollar CDs, commercial paper, BAs, T-bills, money funds
Date short-term interest credited: Accrued daily, paid the 1st of each month
Timeliness of reporting package: Cash statements and inventories within five days of period end; annual interim reports within 20-30 days of period end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, global custodian service, dedicated and immunized bond funds, zero balance disbursement, on-line inquiry & downloading of portfolio data, cash management
Policy for crediting dividends and interest: On payable date in Federal funds
Fee structure: Based on combination of asset value and individual services

NATIONAL TRUST COMPANY
21 King Street East
Toronto, Ontario M5C 1B3
Contact: Julie K. Spergel, marketing consultant, (416) 361-3842

Number of separate master trust clients: 35
Number of directed trust clients: 130
Master trust assets: $2.8 billion
Directed trust assets: $3.2 billion
Custodial employee benefit assets: $6.0 billion
Total employee benefit assets: $9.2 billion
Number of separate portfolios: 80
Average number of accounts per account supervisor: 10
Average number of portfolios per investment manager contact: 3
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: N/A—95% of trades processed through Canadian Depository for Securities (book based system)
Short-term instruments used: Short Term Investment Fund
Date short-term interest credited: Daily
Timeliness of reporting package: Statement of account and market valuation—5 business days; financial statement—10 business days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, benefit disbursement, index fund, global fund
Policy for crediting dividends and interest: On due date; automatically by bond and dividend registers
Fee structure: Based on combination of asset value and individual services

NORTHERN TRUST
50 South LaSalle Street
Chicago, IL 60675
Contact: Thomas W. Kimen, Jr., senior vice president, (312) 630-6000

Number of separate master trust clients: 159—Master Custody included
Number of directed trust clients: 18
Master trust assets: $40.9 billion
Directed trust assets: $20.3 billion
Custodial employee benefit assets: $2.1 billion
Total employee benefit assets: $63.3 billion
Number of separate portfolios: 1825
Average number of accounts per account supervisor: Seven
Average number of portfolios per investment manager contact: 35
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: Yes
Short-term instruments used: Short Term Investment Fund (STIF) for both 401(k) qualified and non-qualified plans
Date short-term interest credited: 3rd business day after month end
Timeliness of reporting package: 3-5 business days after period end, available on-line 24 hours per day
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund, global custody and multi-currency accounting, asset allocation control, dedicated & immunized bond funds, portfolio restructuring, electronic delivery, consulting, options & futures processing, collective fund, investment management, cash management
Policy for crediting dividends and interest: On payable date; funds are credited in good funds and are available for investment on that business day
Fee structure: Based on combination of asset value and individual services

NORWEST BANK MINNEAPOLIS (NATIONAL ASSOCIATION)
8th & Marquette
Minneapolis, MN 55479
Contact: Stephen J. Dillenburg and Robert Edgar, assistant vice presidents, (612) 372-5983

Number of separate master trust clients: 11
Number of directed trust clients: 100
Master trust assets: $1 billion
Directed trust assets: $1.4 bilion
Custodial employee benefit assets: $600 million
Total employee benefit assets: $4.7 bilion
Number of separate portfolios: 441
Average number of accounts per account supervisor: 40
Average number of portfolios per investment manager contact: 4
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: Yes, on sale side
Short-term instruments used: Norwest managers internally a STIF
Date short-term interest credited: First of month
Timeliness of reporting package: Ten business days for consolidated reporting
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, TUCS
Policy for crediting dividends and interest: On payment date through automatic credit
Fee structure: Based on combination of asset value and individual services

OREGON BANK
P.O. Box 2808
Portland, OR 97208
Contact: Arthur W. Kriegsmann, vice president, (503) 636-3709

Number of separate master trust clients: N/A
Number of directed trust clients: 19
Master trust assets: N/A
Directed trust assets: $46.8 million
Custodial employee benefit assets: $56 million
Total employee benefit assets: $102.8 million
Number of separate portfolios: 10
Average number of accounts per account supervisor: 56
Average number of portfolios per investment manager contact: 1.5
Accounting system utilized: Contractual settlement date
Fail float credit provided: No
Short-term instruments used: Trust Funds Prime Obligation
Date short-term interest credited: 4th or 5th of succeeding month
Timeliness of reporting package: Within 2 weeks after close of statement period
Services provided: Portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, master plans
Policy for crediting dividends and interest: On payable date through book entry
Fee structure: Based on individual services performed

REPUBLICBANK DALLAS
P.O. Box 241
Dallas, TX 75221
Contact: David J. Pittman, senior vice president, (214) 922-6506

Number of separate master trust clients: 205
Number of directed trust clients: Included above
Master trust assets: $18.8 billion
Directed trust assets: Included above
Custodial employee benefit assets: $6.8 billion
Total employee benefit assets: $25.6 billion
Number of separate portfolios: 187
Average number of accounts per account supervisor: 10
Average number of portfolios per investment manager contact: 7
Accounting system utilized: Trade date (full accrual), contractual settlement
Fail float credit provided: Yes
Short-term instruments used: Yes
Date short-term interest credited: 1st & 15th
Timeliness of reporting package: 5 business days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund, global custody, manager search and candidate management
Policy for crediting dividends and interest: On payable date in good funds

Fee structure: Based on combination of asset value and individual services

RICHFIELD BANK & TRUST COMPANY
6625 Lyndale Avenue South
Richfield, MN 55423
Contact: Jill Edelstein, employee benefits officer, (612) 861-7355

Number of separate master trust clients: 0
Number of directed trust clients: 800
Master trust assets: 0
Directed trust assets: $128 million
Custodial employee benefit assets: $12 million
Total employee benefit assets: $150 million
Number of separate portfolios: 800
Average number of accounts per account supervisor: 200
Average number of portfolios per investment manager contact: 400
Accounting system utilized: Contractual settlement date
Fail float credit provided: N/A
Short-term instruments used: Money market funds
Date short-term interest credited: First day of month
Timeliness of reporting package: Within 30 days of year end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: On date received
Fee structure: Based on combination of asset value and individual services

ROYAL TRUST
P.O. Box 7500, Station A
Toronto, Ontario M5W 1P9
Contact: Dwight E. Lacey, vice president, sales and marketing, (416) 867-2420

Number of separate master trust clients: 59
Number of directed trust clients: 286
Master trust assets: $6.8 billion
Directed trust assets: $9.26 billion
Custodial employee benefit assets: $9.71 billion
Total employee benefit assets: $14.07 billion
Number of separate portfolios: N/A
Average number of accounts per account supervisor: N/A
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: No
Short-term instruments used: All
Date short-term interest credited: N/A
Timeliness of reporting package: Ten working days
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, benefit disbursement, global custody network, on-line access, uploading & downloading of data, reports available on IBM compatible diskettes
Policy for crediting dividends and interest: On due date through credit to account
Fee structure: Based on combination of asset value and individual services

SAN DIEGO TRUST & SAVINGS BANK
530 Broadway
San Diego, CA 92102
Contact: Paul Barnett, vice president/department head, business trust department, (619) 238-2100

Number of separate master trust clients: 0
Number of directed trust clients: 2076
Master trust assets: 0
Directed trust assets: $464.6 million
Custodial employee benefit assets: $91.4 million
Total employee benefit assets: $519.6 million
Number of separate portfolios: N/A
Average number of accounts per account supervisor: 200
Average number of portfolios per investment manager contact: Not provided
Accounting system utilized: Trade date (full accrual)—cash; contractual settlement date with pending adjustment—five business days; actual settlement date
Fail float credit provided: Yes—held in suspense
Short-term instruments used: Money market, cash management, trust funds
Date short-term interest credited: Settlement date
Timeliness of reporting package: Two weeks after month end
Services provided: Portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: On payable date in cash from corresponding bank
Fee structure: Based on combination of asset value and individual services

SEAFIRST BANK
P.O. Box 3586
Seattle, WA 98124
Contact: Barbara Glenn, assistant vice president, (206) 442-3296

Number of separate master trust clients: 4
Number of directed trust clients: 56
Master trust assets: $59.5 million
Directed trust assets: $472.9 million
Custodial employee benefit assets: $207.6 million
Total employee benefit assets: $1.376 billion
Number of separate portfolios: 115
Average number of accounts per account supervisor: 20
Average number of portfolios per investment manager contact: 15
Accounting system utilized: Contractual settlement date
Fail float credit provided: No
Short-term instruments used: Seafirst Short Term Investment Fund, master note lines, master repo
Date short-term interest credited: Approximately 4 business days after each month end
Timeliness of reporting package: No later than 10 business days following the end of the reporting period
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, index fund (fixed only)
Policy for crediting dividends and interest: Payable date on all but exceptional items through automated system feature
Fee structure: Based on combination of asset value and individual services

SECURITY NORSTAR BANK
One East Avenue
Rochester, NY 14638
Contact: Francis L. Ostrom III, financial planning officer, (716) 546-9214

Number of separate master trust clients: N/A
Number of directed trust clients: 15
Master trust assets: N/A
Directed trust assets: $24.3 million
Custodial employee benefit assets: $140.4 million
Total employee benefit assets: $427.2 million
Number of separate portfolios: 15
Average number of accounts per account supervisor: 5
Average number of portfolios per investment manager contact: 9 with 1 manager, 1 with 4 managers, 2 with 1 manager
Accounting system utilized: Contractual settlement date
Fail float credit provided: No
Short-term instruments used: Daily money market funds
Date short-term interest credited: Monthly within first 5 business days
Timeliness of reporting package: Monthly and/or quarterly
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: Credited to client on payable date, investable next day
Fee structure: Based on combination of asset value and individual services

SOVRAN BANK, N.A.
P.O. Box 26903
Richmond, VA 23261
Contact: Dewey E. Brown, Jr., vice president, (804) 788-2680

Number of separate master trust clients: 8
Number of directed trust clients: 10
Master trust assets: $400 million
Directed trust assets: $15 million
Custodial employee benefit assets: $2.7 billion
Total employee benefit assets: $4.2 billion
Number of separate portfolios: N/A
Average number of accounts per account supervisor: N/A
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: Institutional liquid assets, temporary fund, Fidelity domestic fund, certificates of deposit and bankers' acceptances
Date short-term interest credited: Not provided
Timeliness of reporting package: Reports received by client within one week after period end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance
Policy for crediting dividends and interest: Interest credited on payable date; dividends credited on payable plus one
Fee structure: Based on combination of asset value and individual services

STATE STREET BANK AND TRUST COMPANY
P.O. Box 1713
Boston, MA 02105
Contact: D. Michael Herlihy, vice president, (617) 786-6353

Number of separate master trust clients: 184
Number of directed trust clients: Included above
Master trust assets: $41.8 billion
Directed trust assets: Included above
Custodial employee benefit assets: $36.5 billion
Total employee benefit assets: $78.3 billion
Number of separate portfolios: 1,419
Average number of accounts per account supervisor: 4

Average number of portfolios per investment manager contact: 5
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: Yes
Short-term instruments used: STIF, Government STIF, Maturity Plus STIF, SPIFF, SPIFF Plus, and others (i.e., Synthetic STIF, Institutional Liquid Assets, The Merrill Lynch Fund, and the Common Fund)
Date short-term interest credited: 2nd business day after month-end
Timeliness of reporting package: 5-7 business days after month-end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, market inventory fund, global custody network with multi-currency accounting, plan accounting, pool accounting, 401(k) services, plan advisory services, online client access to portfolio information, client report formatting capability, daily pricing capability
Policy for crediting dividends and interest: As received
Fee structure: Asset value, transaction volume and individual services performed

THE SUMITOMO BANK OF CALIFORNIA

Two Maritime Plaza
San Francisco, CA 94104
Contact: B.R. Otani, vice president & manager-trust, (415) 445-8090

Number of separate master trust clients: (No separate category)
Number of directed trust clients: 324 (includes master trust accounts)
Master trust assets: (No separate category)
Directed trust assets: $130 million
Custodial employee benefit assets: $25 million
Total employee benefit assets: $155 million
Number of separate portfolios: All separate (no commingled)
Average number of accounts per account supervisor: 150
Average number of portfolios per investment manager contact: 10
Accounting system utilized: Actual delivery date
Fail float credit provided: No
Short-term instruments used: Bank money market account, various money market mutual funds
Date short-term interest credited: Not provided
Timeliness of reporting package: As required (within 30 days of period end)
Services provided: Participant recordkeeping, benefit disbursement
Policy for crediting dividends and interest: On payable date through Pacific Depository Trust Company credit
Fee structure: Based on combination of asset value and individual services

THE SUMMIT TRUST COMPANY

367 Springfield Ave.
Summit, NJ 07901
Contact: Joseph Markovich, vice president, (201) 522-8445

Number of separate master trust clients: None
Number of directed trust clients: 30
Master trust assets: None
Directed trust assets: $40.5 million
Custodial employee benefit assets: $3 million
Total employee benefit assets: $190 million
Number of separate portfolios: 33
Average number of accounts per account supervisor: 11
Average number of portfolios per investment manager contact: Not provided
Accounting system utilized: Actual delivery date
Fail float credit provided: No
Short-term instruments used: Federated Investors, Inc: Money Market Trust and Trust for Government Securities plus individual money market issues
Date short-term interest credited: 1st monthly
Timeliness of reporting package: 10 business days after close of period
Services provided: Performance measurement, portfolio analysis, portfolio review, ERISA disclosure assistance, benefit disbursement, tax withholding, issuance of 1099R, W2P
Policy for crediting dividends and interest: Pay date
Fee structure: Based on combination of asset value and individual services

SUN BANK, N.A.

P.O. Box 3808
Orlando, FL 32802
Contact: Victor Zollo, executive vice president, (305) 237-4352

Number of separate master trust clients: 5
Number of directed trust clients: 125
Master trust assets: $125 million
Directed trust assets: $250 million
Custodial employee benefit assets: $100 million
Total employee benefit assets: $477 million
Number of separate portfolios: 125
Average number of accounts per account supervisor: 35
Average number of portfolios per investment manager contact: 85
Accounting system utilized: Contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: Pooled money market fund, commercial paper
Date short-term interest credited: Monthly
Timeliness of reporting package: 20 days after period
Services provided: Portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement
Policy for crediting dividends and interest: On payable date with investable funds on due date
Fee structure: Based on individual services performed

TEXAS COMMERCE BANK

P.O. Box 2558
Houston, TX 77252
Contact: Russell K. Schulze II, senior vice president and trust officer, (713) 236-5788

Number of separate master trust clients: 16
Number of directed trust clients: 17
Master trust assets: $1.428 billion
Directed trust assets: $393 million
Custodial employee benefit assets: $1.407 billion
Total employee benefit assets: $5.106 billion
Number of separate portfolios: 100
Average number of accounts per account supervisor: 25
Average number of portfolios per investment manager contact: 3
Accounting system utilized: Actual delivery date
Fail float credit provided: No
Short-term instruments used: Master notes, repos, commercial paper in commingled funds
Date short-term interest credited: Month end
Timeliness of reporting package: 7 business days after month end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, benefit disbursement
Policy for crediting dividends and interest: On payable date + one; credited to account
Fee structure: Based on combination of asset value and individual services

TRUST COMPANY BANK

25 Park Place NE
Atlanta, GA 30303
Contact: Dewey Haggard, vice president, (404) 588-7583

Number of separate master trust clients: 15
Number of directed trust clients: 25 accounts
Master trust assets: $614 million
Directed trust assets: $250 million
Custodial employee benefit assets: N/A
Total employee benefit assets: $1.4 billion under management
Number of separate portfolios: 48
Average number of accounts per account supervisor: 6
Average number of portfolios per investment manager contact: Not provided
Accounting system utilized: Provides both trade date and settlement date accounting
Fail float credit provided: No
Short-term instruments used: Short term investment fund, master notes
Date short-term interest credited: 1st business day of month
Timeliness of reporting package: Statements are provided to clients 14 business days after the period end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, benefit disbursement
Policy for crediting dividends and interest: On payment date—investable funds/Federal funds
Fee structure: Based on combination of asset value and individual services

UNITED MISSOURI BANK OF KANSAS CITY, N.A.

P.O. Box 226
Kansas City, MO 64141
Contact: Robert E. Reiter, senior vice president, (816) 556-7474

Number of separate master trust clients: 15
Number of directed trust clients: 335
Master trust assets: $500 million
Directed trust assets: $795 million
Custodial employee benefit assets: $600 million
Total employee benefit assets: $1.95 billion
Number of separate portfolios: 515
Average number of accounts per account supervisor: 25
Average number of portfolios per investment manager contact: 5
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: No
Short-term instruments used: Short term money market and UMB Money Market Fund are primary; various other secondary instruments also used
Date short-term interest credited: 8-14 days after month end
Timeliness of reporting package: 2-21 days, depending on investments held
Services provided: Performance measurement, portfolio analysis, portfolio review, particpant recordkeeping, ERISA disclosure assistance, benefit disbursement, prototype plans
Policy for crediting dividends and interest: On payable date in cash or in kind

Fee structure: Based on combination of asset value and individual services

U. S. NATIONAL BANK OF OREGON

309 S.W. 6th Ave.
P.O. Box 3168
Portland, OR 97208
Contact: Marianne Nelson, trust officer, sales and marketing, (503) 225-6900

Number of separate master trust clients: 13
Number of directed trust clients: 79
Master trust assets: $69.7 million
Directed trust assets: $289.7 million
Custodial employee benefit assets: $135.1 million
Total employee benefit assets: $598.8 million
Number of separate portfolios: 158
Average number of accounts per account supervisor: 72
Average number of portfolios per investment manager contact: 3
Accounting system utilized: Contractual settlement date
Fail float credit provided: Yes
Short-term instruments used: Qualivest money market fund, Federated Money Market Fund, Ford Motor Master Note, General Electric Master Note, GM Master Note, Merrill Lynch repo, Merrill Lynch Master Note, institutional liquid assets
Date short-term interest credited: Pay date
Timeliness of reporting package: Within 10 business days after month-end
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, trustee services, prototype defined contribution plans
Policy for crediting dividends and interest: On pay date using automatic book entry through DTC; payment directly to account
Fee structure: Based on combination of asset value and individual services

UNITED STATES TRUST COMPANY

45 Wall Street
New York, NY 10005
Contact: Robert Pagano, vice president, (212) 806-3834

Number of separate master trust clients: 36
Number of directed trust clients: 75
Master trust assets: $3.0 billion
Other directed trust assets: $5.5 billion
Other custodial employee benefit assets: $2.5 billion
Total employee benefit assets: $11.0 billion
Number of separate portfolios: 501
Average number of accounts per account supervisor: 60
Average number of portfolios per investment manager contact: 60
Accounting system utilized: Options—Trade date (full accrual) or actual delivery date
Fail float credit provided: Yes
Short-term instruments used: Pooled funds and demand notes
Date short-term interest credited: 3rd business day of month
Timeliness of reporting package: 5-15 days after month end
Services provided: Performance measurement, securities lending, ERISA disclosure assistance, benefit disbursement, index fund
Policy for crediting dividends and interest: On payable date in Fed funds
Fee structure: Based on combination of asset value and individual services

UNITED VIRGINIA BANK

919 East Main Street
Richmond, VA 23219
Contact: Lucy B. Lewis, new business representative, (804) 782-7405

Number of separate master trust clients: 3
Number of directed trust clients: 80
Master trust assets: $33 million
Directed trust assets: $265 million
Custodial employee benefit assets: $588.4 million
Total employee benefit assets: $1.699 billion
Number of separate portfolios: 164
Average number of accounts per account supervisor: 25
Average number of portfolios per investment manager contact: 15
Accounting system utilized: Trade date (full accrual) on annual statements; contractual settlement date on monthly reports
Fail float credit provided: No
Short-term instruments used: In-house short term investment fund
Date short-term interest credited: 5th business day of following month
Timeliness of reporting package: 15th day of following month
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund
Policy for crediting dividends and interest: Dividends—Pay date + 1, interest—pay date, cash credit to account
Fee structure: Based on combination of asset value and individual services

VALLEY FIDELTY BANK & TRUST COMPANY

601 Market Street
P.O. Box 1991
Knoxville, TN 37901
Contact Sharon J. Miller, senior vice president and trust officer, (615) 521-3966

Number of separate master trust clients: 310
Number of directed trust clients: 85
Master trust assets: $113.4 million
Directed trust assets: $16.6. million
Custodial employee benefit assets: 0
Total employee benefit assets: $130,000
Number of separate portfolios: 2
Average number of accounts per account supervisor: 200
Average number of portfolios per investment manager contact: 1
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: N/A
Short-term instruments used: Commercial paper, money market funds, Government money market funds, T-bills, & CDs
Date short-term interest credited: Monthly—by 3rd day of month
Timeliness of reporting package: 2 weeks after year end or 2 weeks from date of receipt of accrued contribution
Services provided: Performance measurement, portfolio review, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, market inventory fund, initial plan installation, employee meeting with participants
Policy for crediting dividends and interest: Payable date + 1 day; credit account if due, not if received. If dividend/interest not received, we pay out of suspense
Fee structure: Based on contribution of asset value and individual services

VALLEY NATIONAL BANK OF ARIZONA

P.O. Box 71, A-814
Phoenix, AZ 85001
Contact: Paul Knowles, vice president, (602) 261-1895

Number of separate master trust clients: 6
Number of directed trust clients: 76
Master trust assets: $33.9 million
Directed trust assets: $138 million
Custodial employee benefit assets: $21.5 million
Total employee benefit assets: $622.8 million
Number of separate portfolios: 500
Average number of accounts per account supervisor: 110
Average number of portfolios per investment manager contact: 250
Accounting system utilized: Trade date (full accrual)
Fail float credit provided: No
Short-term instruments used: Short Term Investment Co., Federated GMAC
Date short-term interest credited: First
Timeliness of reporting package: Normally statements are generated 8 days after month end
Services provided: Performance measurement, participant recordkeeping, ERISA disclosure assistance, benefit disbursement, plan administration services
Policy for crediting dividends and interest: On payable date
Fee structure: Based on combination of asset value and individual services

WACHOVIA BANK & TRUST COMPANY, N.A.

P.O. Box 3099
Winston-Salem, NC 27150
Contact: Jane B. Fisher, vice president, (919) 770-6348

Number of separate master trust clients: 43
Number of directed trust clients: 55
Master trust assets: $16.247 billion
Directed trust assets: $500 million
Custodial employee benefit assets: $525 million
Total employee benefit assets: $17,775 billion (unaudited)
Number of separate portfolios: 400
Average number of accounts per account supervisor: 5
Average number of portfolios per investment manager contact: 17
Accounting system utilized: Contractual settlement date with pending adjustment
Fail float credit provided: Yes
Short-term instruments used: Short term funds, demand notes, Treasury notes
Date short-term interest credited: First working day
Timeliness of reporting package: 10 business days or less
Services provided: Performance measurement, portfolio analysis, portfolio review, participant recordkeeping, securities lending, ERISA disclosure assistance, benefit disbursement, index fund, global custody, Wilshire Trust Universe Comparison Service, venture capital investing, 401(k) consulting, online access, PAYSOP administration
Policy for crediting dividends and interest: On payable date in Federal funds
Fee structure: Based on combination of asset value and individual services

WELLS FARGO BANK, N.A.

P.O. Box 63050
San Francisco, CA 94163

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Calendar

Dec. 9-10: Health Care Cost Containment (for employers only), Chicago. Contact: Bill Hembree, Health Research Institute, 49 Quail Court, Suite 200, Walnut Creek, CA 94596, (415) 676-2320.

Dec. 9-10: Multiemployer Pension Plan Issues and Problems, Washington, D.C. Contact: MPPAA Conference Registrar, BNA Conferences, 2550 M Street, NW, Suite 699, Washington, D.C. 20037, (800) 424-9890 or (202) 452-4420 in the Washington, D.C. metropolitan area.

Dec. 9-10: Private Placement in Real Estate, Tampa; **Dec. 10-11,** Boston. Contact: Northwest Center for Professional Education, 13555 Bel-Red Road, C-96870, Bellevue, WA 98009, (800) 426-5575 or (206) 746-4173 in Washington State.

Dec. 10-12: The Eleventh World Banking Conference, London. Contact: Janet Beckingsale, Financial Times Conference Organisation, Minster House, Arthur Street, London EC4R 9AX, Int. (441) 621-1355.

Dec. 10-13: Short Course on Securities Regulation, Dallas, TX. Contact: Cindie J. Burkel, The Southwestern Legal Foundation, P.O. Box 830707, Richardson, TX 75083, (214) 690-2377.

Dec. 16-17: Advanced Money Market/Cash Management for Governments, Orlando, Fla. Contact: Karen H. Nelson, GFOA Career Development Center, 180 North Michigan Avenue, Suite 800, Chicago, IL 60601, (312) 977-9700.

Dec. 16-18: Basic/Intermediate Financial Futures School, Chicago. Contact: Mimi Scanlon, The Chicago Corporation, 208 S. LaSalle Street, Chicago, IL 60604, (800) 638-5716 or (312) 855-7769.

Dec. 17: How to Convert Your Company's Pension Plan from a Millstone to a Milestone, Greenville, S.C. Contact: Pension Workshop, Financial Services Group Inc., P.O. Box 10168, Greenville, SC 29603, (803) 271-4717.

Dec. 18-19: Advanced Governmental Budgeting, Orlando, Fla. Contact: Karen H. Nelson, GFOA Career Development Center, 180 North Michigan Avenue, Suite 800, Chicago, IL 60601, (321) 977-9700.

Dec. 18-20: Advanced Financial Reporting for Governments, Orlando, Fla. Contact: Karen H. Nelson, 180 North Michigan Avenue, Suite 800, Chicago, IL 60601, (312) 977-9700.

Dec. 19: Managing Employee Benefits, Utica, NY. Contact: American Society for Personnel Administration, 606 N. Washington Street, Alexandria, VA 22314, (703) 548-3440.

Jan. 21-22: Flexible Compensation Conference, Washington, D.C. Contact: Charles D. Spencer & Associates, Inc., 222 W. Adams Street, Chicago, IL 60606, (312) 236-2615.

Feb. 2-5: ABA National Trust Conference, Orlando, FL. Contact: ABA Banker Education Network, 1120 Connecticut Avenue, N.W., Washington, D.C. 20036, (202) 467-6738.

Feb. 13-14: International Benefits Information Service Interchange, Toronto, Canada. Contact: Charles D. Spencer & Associates, Inc., 222 W. Adams Street, Chicago, IL 60606, (312) 236-2615.

Feb. 17-19: Fifth Annual Pension Seminar, Kissimmee, FL. Contact: Brenda Chatham, Corbel & Co., P.O. Box 17548, Jacksonville, FL 32245-7548, (904) 731-4455.

Feb. 26-28: International Benefits Information Service Institute, Brussels, Belgium. Contact: Charles D. Spencer & Associates, Inc., 222 W. Adams Street, Chicago, IL 60606, (312) 236-2615.

Mar. 16-19: ABA National Fiduciary and Securities Operations Conference, Atlanta. Contact: ABA Banker Education Network, 1120 Connecticut Avenue, N.W., Washington, D.C. 20036, (202) 467-6738.

Apr. 7-9: Pension Consultants Conference, Sand Key, FL. Contact: Charles D. Spencer & Associates, Inc., 222 W. Adams Street, Chicago, IL 60606, (312) 236-2615.

Apr. 13-18: 24th Annual Risk Management and Employee Benefits Conference, Toronto. Contact: RIMS Conference Department, 205 East 42nd Street, New York, NY 10017, (212) 286-9292.

Apr. 21-23: Employee Benefit Plan Conference, New Orleans. Contact: Charles D. Spencer & Associates, Inc., 222 W. Adams Street, Chicago, IL 60606, (312) 236-2615.

May 18-21: Fifth Annual Employee Benefits Symposium, San Diego (for CEBS graduates exclusively). Contact: International Society of Certified Employee Benefits Specialists, P.O. Box 209, Brookfield, WI 53005-0209. (414) 786-8771.

Master Trust Directory

Continued from page 70

Contact: Bruce Simon, manager of business and product development, (415) 396-4204

In March 1985 Wells Fargo decided to discontinue its master trust operation and is in the process of phasing out that business. It will, however, continue to provide trustee and investment management services to smaller pension and profit sharing plans in the $500,000 to $20 million range.

Number of separate portfolios: Approx. 500
Average number of accounts per account supervisor: Approx. 70
Average number of portfolios per investment manager contact: N/A
Accounting system utilized: Settlement date accounting used. All trades are settled on contractual settlement date.
Fail float credit provided: Not currently available
Short-term instruments used: Yes
Date short-term interest credited: Last day of the month
Timeliness of reporting package: Determined by customer deadlines
Services provided: Performance measurement, portfolio review, securities lending, benefit disbursement, index fund, Three-way Asset Allocation Fund
Policy for crediting dividends and interest: On payable date through credit to account
Fee structure: Based on combination of asset value and individual services.

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JANUARY 1986

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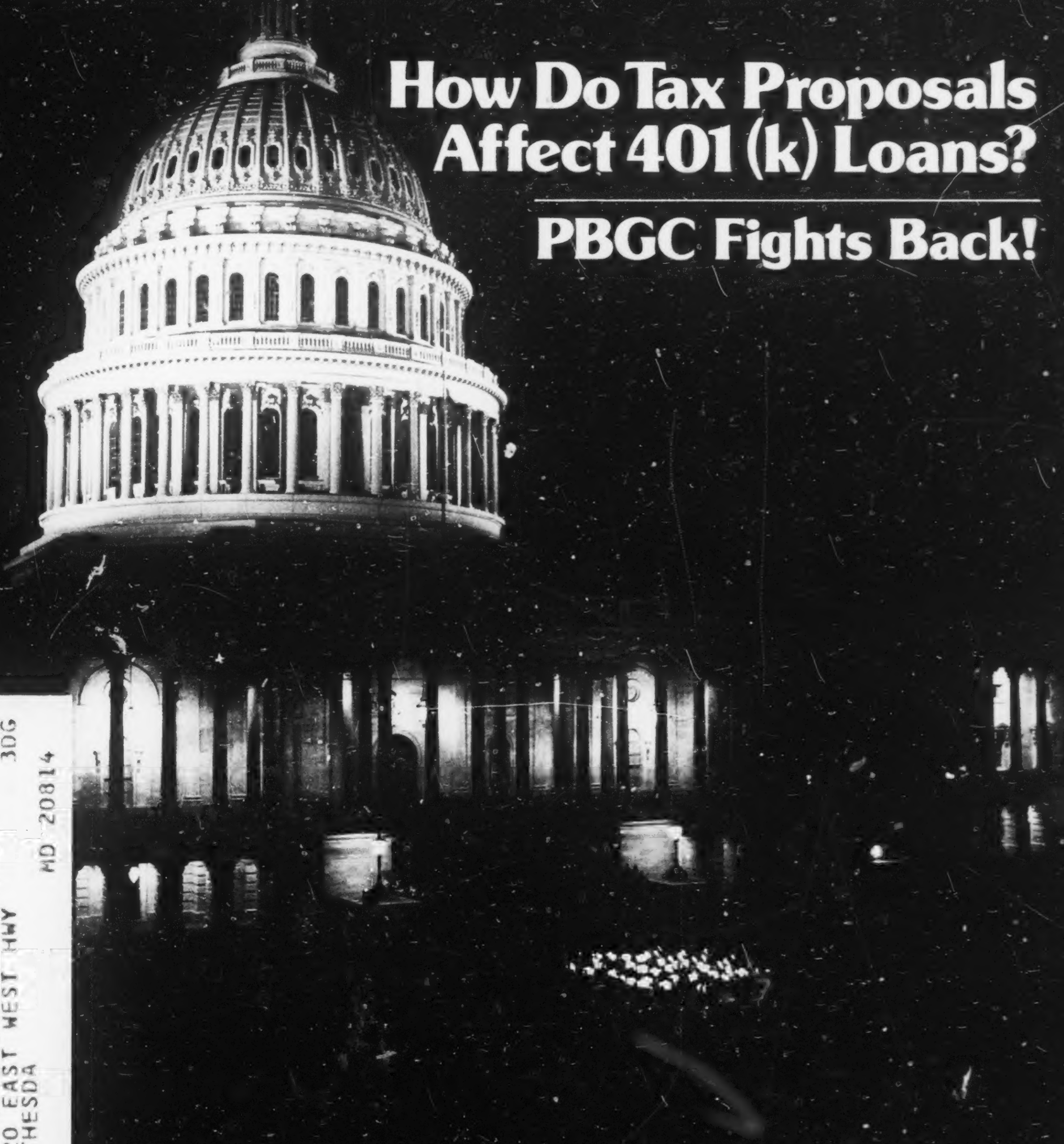
The Magazine for Plan Sponsors and Investment Managers/ A Publication of Communication Channels, Inc.



How Do Tax Proposals Affect 401 (k) Loans?

PBGC Fights Back!

PEN31025709 021
A SCHWARZ
CONGRESSIONAL INFO SERV 3DG
4520 EAST WEST HWY
BETHESDA MD 20814

Pension World

January 1986
Volume 22 Number 1

The Magazine for Plan Sponsors and Investment Managers/A Publication of Communication Channels, Inc.

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Cover: **The Capitol provides a backdrop this month as legislative issues are highlighted. National Geographic Society Photographer; courtesy of the U.S. Capitol Historical Society. Mark Weinstein's story on the fate of 401(k) loans begins on page 25.**

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Stalking the elusive "real return" on investments

Insurance companies offer retirement funds a vast array of products. But whatever the product, from "universal life insurance" to defined benefit retirement plans to annuities, the basic functions of the institutions are the same: (1) to accept funds in trust for participants, (2) to maintain or increase the purchasing power of those funds with minimum risk and (3) to return the enhanced purchasing power to participants when they need it. For pension plans covered by ERISA (the Employee Retirement Income Security Act), the obligation to participants is more than a moral one. ERISA requires that such plans be invested and managed for the "exclusive benefit" of participants and beneficiaries.

It is not enough that institutional investors earn high nominal yields. Pensioners need purchasing power, not nominal dollars. The goal of institutional investment managers, therefore, should be to earn the maximum real return on invested funds which can be obtained consistent with participant risk preferences. Yet there is ample evidence that participant interests are being seriously suboptimized. In fact, it is a rare pension fund or insurance company investment manager who even conceptualizes the job in terms of purchasing power or real returns. This article will describe the worsening record of institutional investing over the last 25 years, discuss current prospects, and propose a solution.

The record

Until the 1970s, institutions were able to earn stable and positive real returns on invested assets. Figure 1 shows the investment performance of U.S. life insurance companies from 1960 through 1972. Real returns were generally positive and stable, averaging 1.87 percent. The standard asset in institutional portfolios was a low-default-risk debt security insured or guaranteed by a government agency or secured by a first mortgage on a capital asset. There were exceptions, of course. Some institutions, thinking that inflation might someday get out of hand, developed portfolios of equity securities under the belief that equities provided an inflation hedge. Early issues of Nobel laureate Paul Samuelson's famous economics text endorsed this idea. Later editions eliminated it. Samuelson now calls the belief that equity investments offer protection against unexpected changes in inflation one of the "myths" of institutional investment. No popular investment security, whether debt or equity, is immune from the effects of inflation.

Inflation peaked at 12.2 percent in 1974, then fell back for a time, again reaching double digit levels in 1979 and 1980. Figure 2 shows how insurance companies fared from 1973 through 1984. In contrast to the earlier period, these years saw highly volatile real yields, averaging just below zero. While the data in Figures 1 and 2 apply specifically to life insurance companies, pension funds saw an almost identical pattern, with small funds earning slightly less and large funds slightly more than the industry.

Of course, market interest rates and required rates of returns on equity investment rose markedly to offset the effects of expected inflation and to compensate providers of funds for accepting the risk that inflation would be higher than expected. Market interest rates on mortgages, first mortgage bonds, and mortgage-backed securities reached levels of 14 to 16 percent and the prime rate exceeded 20 percent at one point in 1981.

Acutely aware of the need to earn positive real returns and under increasing criticism for not doing so, institutional investment managers remembered Samuelson's old "wisdom" of the 1950s and early sixties, when most of them had gone to college. But they forgot—or failed to learn—his new wisdom. Many institutions began to shift aggressively toward equity positions, especially in real estate. Such a shift was understandable because with inflation high and volatile, inflation risk on dollar-denominated securities was orders of magnitude greater than the business risk which earlier had distinguished debt from equity. For example, a typical fixed-rate mortgage portfolio of 1977 lost more than 30 percent of its market value by the end of 1980. Even a 100 percent default rate would not produce losses this high (defaults, on average, cost less than 15 percent of loan balance).

For some institutions, the shift toward ownership of equity real estate was unintentional. Many lenders had accepted low debt coverages and high loan-to-value ratios, expecting continuing inflation to in-

by **ARTHUR SHARPLIN**
Associate Professor of Management
Northeast Louisiana University
Monroe, La.

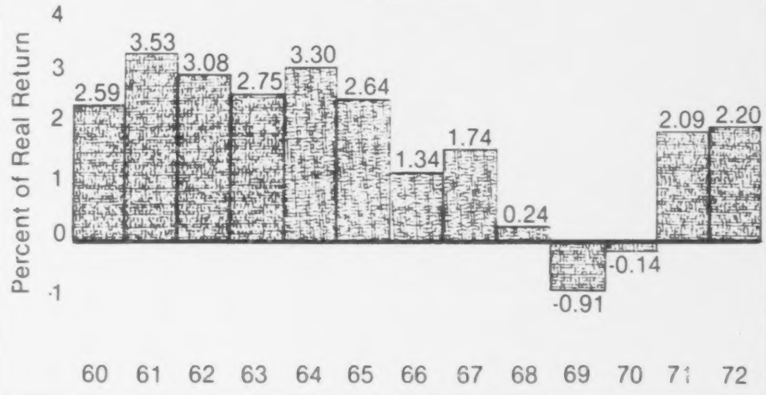
flate property values and income streams. Also, many variable-rate mortgages had been made with the early-period interest rates bought down. When the buy-down periods ended, some of these became distressed properties because the expected inflation did not occur and property incomes were suddenly less than debt service requirements. For these and other reasons, many institutions inadvertently became holders of large amounts of owned real estate. Some aggressively set about to purchase properties outright as an inflation hedge. Still others offered interest rate concessions in exchange for a share of property income.

By 1985, even conservative pension funds had substantial owned real estate (and often other physical assets as well). For example, the California State Employees Fund owned more than $1 billion in real estate equity. Even though the ownership of physical assets was unintentional for many institutions, practically all had to buy or develop management capability. Because economies of scale are important for commercial property management, there were incentives for institutions to increase their real estate holdings. David Glickman of Heitman Financial Services estimates that internal management of properties is impractical for institutions holding less than $100 million in real estate equity.

A pattern developed which would have been anathema to the conservative institutional investment manager of the 1960s. Many institutional investors moved beyond 100 percent equity positions and began to purchase real estate equity which was leveraged with debt held by other institutions.

So, in increments, institutional investment manag~~ers move~~d from government guaranteed loans and mortgages for 70 to 80 percent of value on real estate and other assets to loans with loan-to-value and debt-coverage ratios near 1.0; then to participating loans (which effectively made the institution part owner of the already-small equity); then to 100 percent ownership of real estate; and, finally, to the ownership of leveraged equity positions in real estate. Looking back over the record of the 1970s, some investment managers discovered that they would have done better by investing in U.S. Treasury bills, thereby earning positive real returns while diminishing inflation risk and practically eliminating default risk. So, some shifted funds to short-term government securities just in time for the collapse of T-bill rates in 1985.

Figure 1: Real Return on Total Invested Assets
All U.S. Life Insurance Companies
1960-1972

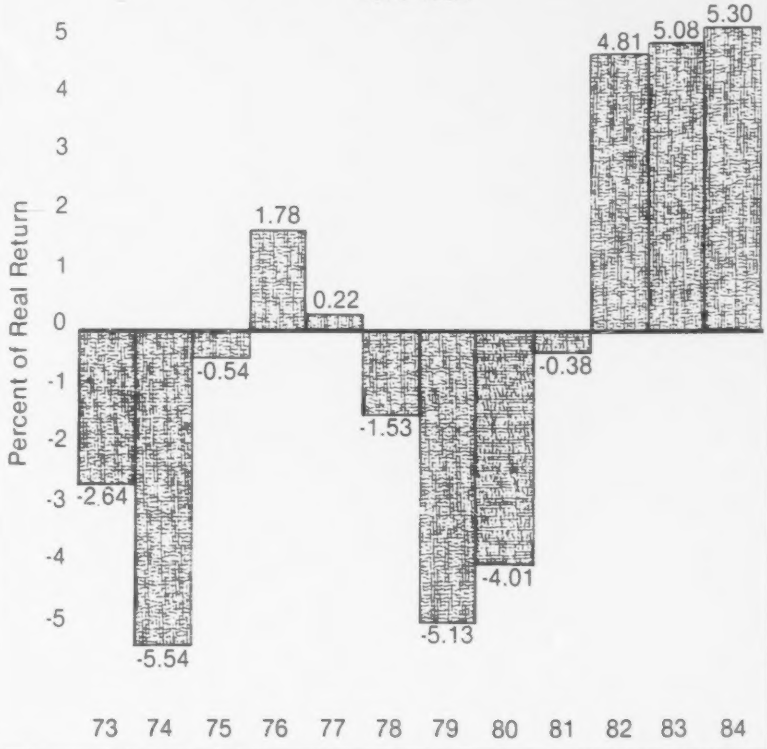


In summary, although participants continue to entrust their resources to institutions, those institutions in general have neither significantly increased the purchasing power of those resources nor honored participants' obvious preferences for minimum risk.

There are many in the investment community who believe that *this time* they have outsmarted inflation. That is optimistic.

At a recent New York symposium for the Coffee, Sugar, and Cocoa Exchange, Columbia University's Philip Cagan proved beyond any reasonable doubt that no one has ever been able to predict in-

Figure 2: Real Return on Total Invested Assets
All U.S. Life Insurance Companies
1973-1984



flation. In fact, Dr. Cagan showed that using the previous year's inflation rate as a predictor of the current year's rate provided the highest forecasting accuracy—better than a panel of professional forecasters, better than a panel of economists, and, of course, better than a group of ordinary citizens.

Some believe that no matter what inflation turns out to be, their participating mortgages or variable rate mortgages or leveraged or unleveraged equity positions in real estate will beat it. There is not a shred of evidence to suggest that this is true. With particular regard to participating loans (which provide, for example, that one-half of any nominal rent increases will go to the lender), this sharing of the benefits of good property management will certainly ensure suboptimal management. For example, a developer who has two properties, one with a nonparticipating loan and the other with a participating loan, will surely focus attention and resources on the property with the nonparticipating loan. In addition, the lender has already given up a percentage of fixed yield in exchange for the rent sharing. If the contemplated inflation does not occur or, God forbid, if zero or negative price level changes occur, rents may in fact decline, causing operating income to fall below that required to service the debt. If high inflation occurs, surely rents will lag that inflation on average by two or three percent a year. This will occur because as property depreciates, it produces a declining real income stream. In all likelihood, rents on properties financed with participating loans will lag inflation more than average because of suboptimal management. So, for every point of inflation which occurs, the real value of the lender's principal balance will be reduced by one percent. Nominal rents might increase by one-half or two-thirds of a percentage point, but the lender will get only half of that, far too little to offset the decline in the value of the lender's principal balance.

In addition, if inflation expectations return to their levels of 1980, market interest rates will very quickly move up several percentage points, greatly devaluing all long-term, fixed-rate loans. For variable-rate loans, unexpected inflation will not be incorporated into interest rates until it has already devalued principal balances.

A "real" solution

As dismal as the situation may seem, there is a readily available solution, one which has already been applied on a small scale in Utah, Georgia and Louisiana. That solution is price-level-adjusted debt securities. As previously shown, inflation risk is orders of magnitude greater than the maximum default risk any lender will knowingly accept. But unlike default risk, inflation risk *is* avoidable. Using any of several simple price-level-adjusted loan designs, it is possible to make the lending contract in real (that is, purchasing power) terms and to carry it out in real terms.

> *"Using any of several simple price-level-adjusted loan designs, it is possible to make the lending contract in real terms and to carry it out in real terms."*

There are those who will say, "Borrowers will never accept inflation adjustment. They want to know what their payments will be." There are two answers to this point. First, a borrower on a fixed-rate, variable-rate, or participating loan has no idea what the payments will be just a few years in the future or over the life of the loan. Yes, the borrower knows the numbers that will be written on the checks to make those payments, but those numbers only have meaning to the extent that they represent purchasing power. If inflation turns out to be two percent annually, for example, one dollar ten years in the future will purchase what $0.82 will buy today. If inflation turns out to be 15 percent on average, the dollar will buy what a quarter will buy today. So within what might be a typical borrower's 90 percent confidence interval for inflation, the payment may vary by a factor of three.

The second, and more compelling, retort is that borrowers have accepted such loans already and whether they will do so in the future is dependent upon the interest rates which are available. In Utah, the State Teachers Retirement Fund is earning four percent real yield on $50 million in price-level-adjusted residential mortgages. A much smaller volume of price-level-adjusted mortgages were made to home buyers near Atlanta by a New York company more than ten years ago. Finally, in Louisiana a limited number of commercial mortgage loans of $445,000 and under are yielding the lender astounding real yields of eight and nine percent.

Prospective borrowers may ask, "Why would lenders make real-dollar loans at four percent when they can earn, say, 12 percent on regular loans?" One fallacy suggested by such a question is the comparison of nominal interest rates with real interest rates. *Nominal* means "in name only; usually not in fact." *Real* means "not merely so-called; truly possessing the essence of what it is called." A nominal interest rate of 12 percent may turn out to be any positive or negative real rate, depending on the inflation which occurs over the term for which the interest rate is fixed.

Further, since inflation risk is overwhelmingly the major risk in mortgage lending today and price-level-adjusted loans eliminate this risk, institutional lenders should be willing to loan at a lower expected rate on price-level-adjusted loans than on alternative designs. Therefore, a rational institutional investment manager, aware of the past record, should be grateful for an opportunity to earn one or two percent on a price-level-adjusted debt security of average default risk.

There is no necessity to be content, however, with such yields. There is ample evidence that four or five percent real yields are available in every state and city in America. Even a rapid-amortization, price-level-adjusted mortgage (called a Real Dollar Payback or RDP loan) which yields four percent real interest will have debt service payments of less than 60 percent of those on a 12 percent standard mortgage. To be viable in today's real estate market, a commercial project must produce annual net operating income approximating ten percent of proj-

Continued on next page

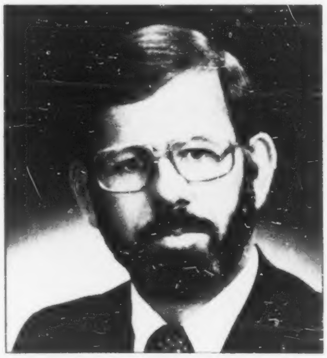
Investment return

Continued from opposite page

ect value. With a four percent RDP loan, such a project would provide about half of its net operating income as cash flow to the equity holders. It would also give the typical institutional lender at least twice the real yield that lender has been able to earn in the past, and with a level of risk (inflation risk plus default risk) which is miniscule in comparison to the risk of a fixed-rate, variable-rate, or participating loan.

Conclusion

Inflation risk is a creature of mortgage design. It can be essentially eliminated through the use of RDP mortgages. A portfolio of such mortgages will provide the institutional investor a guaranteed real yield much higher than the average of the highly volatile yields earned in the past. Pension funds and insurance companies have the capability of originating RDP mortgages themselves. In general, there is no necessity for the passage of new laws or even government agency approval. Forms design only requires the modification of existing documents. The only reason an institutional investment manager should hesitate is the belief that the next turn of the inflation wheel is predictable. Given a decades-long record of failure, only the compulsive gambler believes that it is. ☐



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Master trust

Continued from page 32

of ancillary services such as: benefit disbursement, performance measurement, analytics, security lending and specialized cash management vehicles.

- The sponsors who drive the master trust product have growing technological appetites. As these appetites build, the number of banks capable of feeding such huge appetites decreases.

Pressures on profit will require master trustees to consolidate in order to survive and to respond to the ever-increasing needs of the marketplace. Consolidation will present new opportunities for growth for the anticipated eight to ten surviving banks. Capitalizing on such opportunities will depend heavily on the banks ability to meet the demands of clients.

The surviving master trustees may take on a new client — other banks. A concept of ''private label'' master trust services will be offered to regional banks unable to release master trust clients with major banking relationships, interlocking boards, or other special relationships. This new service will remove the back-office operation from those banks unable to commit the dollars necessary to remain state-of-the-art. It will create even greater efficiencies because the entire securities settlement process, trust department general ledger and government reporting requirements can be obtained through such an operation.

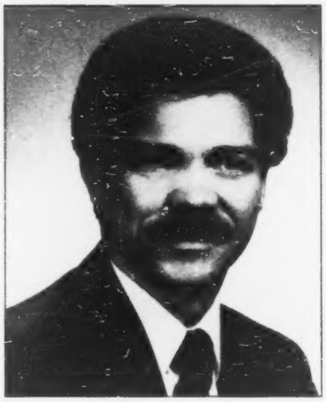
In many instances, it will be transparent to trust department customers that a major master trustee bank is providing the entire system. Clients can still deal directly with their own trusted employee benefit administrator. However, this administrator will deal directly with the master trustee as he does now with his own operations area.

In addition to regional banks seeking the services of master trustee banks, the investment subsidiaries of trust departments mark an even greater opportunity. These ventures are very bottom-line oriented and must maintain innovative approaches. The cost-effectiveness of master trust, uniformity of administration and a superior reporting process are the added pluses to be obtained.

Along with the consolidation of master trustees, we also see a shift to defined contribution occurring among plan sponsors. In addition, we believe the master trust product will expand to the government marketplace and foundation/institutional relationships.

The end result of these forces will be an even greater emphasis by master trustees on personalized service. Master trust will remain a high tech market-driven product; data downloading and reports created instantaneously by plan sponsors will be the norm. Systems will be upgraded to permit daily performance calculations and comparisons to universes. On the defined contribution recordkeeping side of the business, participant statements will be generated monthly rather than semi-annually or annually. On-line benefit disbursement systems will be available for customer inquiry and/or actual updating.

All of these advances will require dollar commitments in the millions by each master trustee who chooses to remain a vital part of the future. Opportunity awaits those master trustees that have made the commitment. ☐



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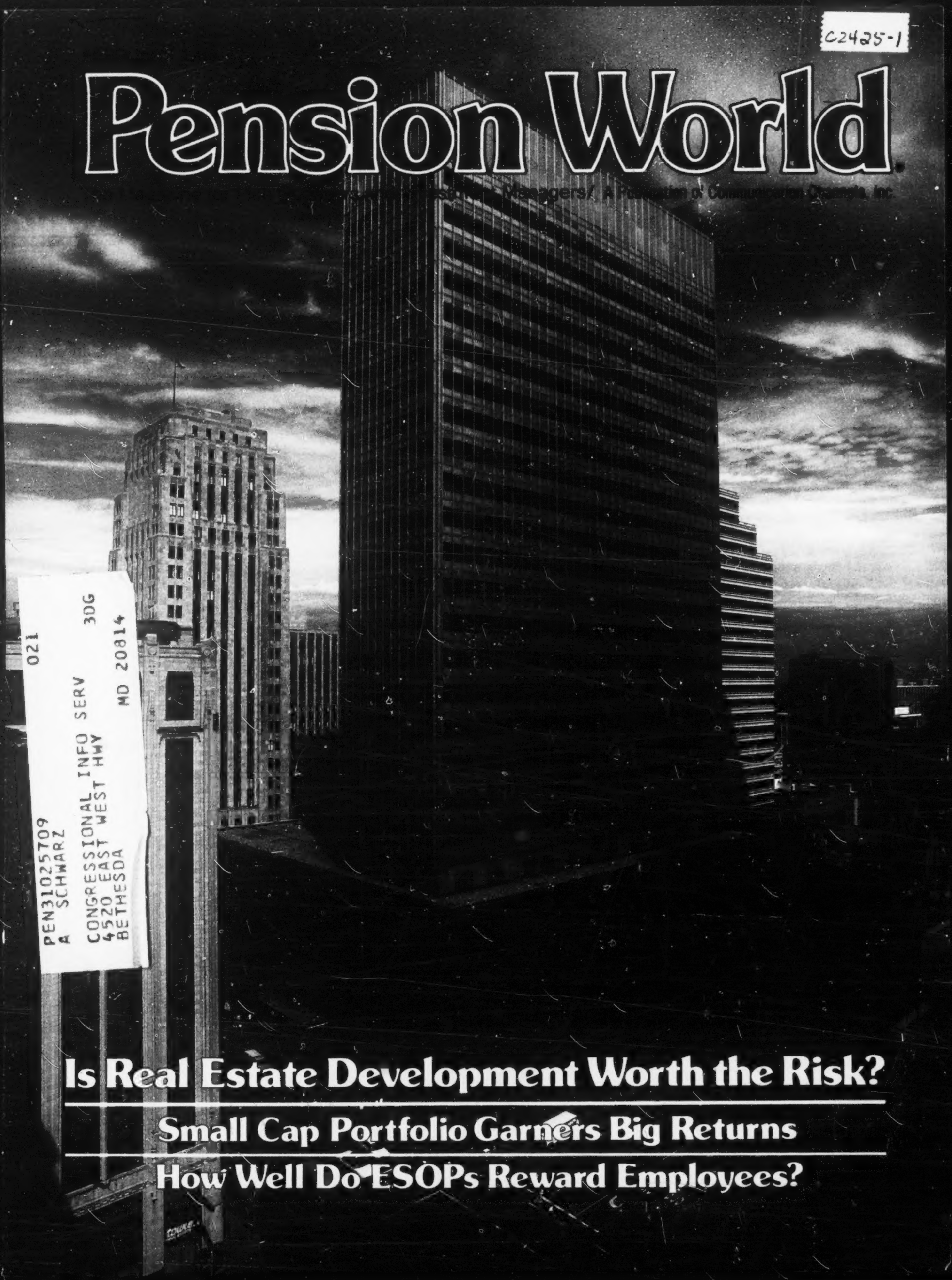

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Is Real Estate Development Worth the Risk?

Small Cap Portfolio Garners Big Returns

How Well Do ESOPs Reward Employees?

Pension World

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Cover: **First Bank Place West, Minneapolis, is a 404,000-square-foot office building owned by the HAC Group Trust and two separate account pension fund investors. Photo courtesy Heitman Advisory Corporation, Chicago.**

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Small cap portfolio garners big returns

The investment of pension fund assets has become increasingly complex over the past five years. During this time, pension assets have more than doubled to approximately $1 trillion, giving rise to a growing dominance of institutional investors in the equity and debt markets. A large infusion of capital into the financial markets by a relatively small number of institutional investors has created a higher degree of volatility than existed in 1980.

Disgruntled by mediocre equity returns, many pension funds have been prompted to reassess their equity investment strategies. They have begun to take a broader view of the equity universe, looking beyond conventional large capitalization issues. One area of the equity market that has experienced superior growth over the past several decades and has recently attracted growing attention from plan sponsors is small capitalization stocks.

Large vs. small cap

Market capitalization is a corporation's total number of shares outstanding multiplied by the current price per share. IBM, a large capitalization issue, for example, has a market capitalization of approximately $72 billion. On average, the market cap of stocks represented in the S&P 500 is in excess of $11 billion. By contrast, the vast majority of stocks in the universe of approximately 7000 publicly traded companies have much smaller market capitalizations. Mass Mutual's Small Company Fund, for example, concentrates on companies with market capitalizations of no greater than $150 million. Small cap stocks tend to be underowned by institutions and underfollowed by Wall Street analysts and therefore are less influenced by institutional activity. Consequently, this sector of the market provides an opportunity for greater price inefficiencies and potentially greater financial rewards.

The firm of R. G. Ibbotson & Associates, Chicago, publishes the annual returns of a universe of small capitalization securities. A review of these year-by-year returns indicates:

1. Small capitalization stocks have consistently outperformed large-capitalization issues.
2. The prices of small and large capitalization stocks do not always move synchronously with respect to timing, direction and magnitude.

In three of the past 10 years, for example, small capitalization stocks outperformed large capitalization issues by over 25 percent. And in two of the past 10 years, small cap stocks generated substantial positive returns while large cap issues posted negative results. In 1984, the reverse situation occurred. This type of asynchronous behavior provides investment exposure for a variety of economic outcomes.

Although small capitalization issues offer outstanding investment opportunities, pension fund managers are not turning their backs on large capitalization stocks entirely. Rather, they are diversifying their equity portfolios among both large and small capitalization issues. A recent survey by Mass Mutual of more than 140 defined benefit plans indicated that more than 30 percent of plans use more than one equity manager. And, among these plans, the secondary manager tends to specialize in small cap or aggressive growth stocks. Plan sponsors are beginning to diversify among different types of equity managers because studies reveal that investment exposure to different market segments can work to enhance a portfolio's investment returns without adding a commensurately higher degree of risk. Over the past 10 years, an equity portfolio 50 percent invested in small capitalization stocks and 50 percent invested in the S&P 500, for example, would have generated a 53 percent greater return than the S&P 500 alone with only a marginal increase in risk as measured by the standard deviation of returns.

In 1979, in response to plan sponsors' needs for more stable and predictable equity returns, Mass Mutual began studying small capitalization stocks. We recognized this area of the market as a viable source for portfolio diversification. We concluded that although the term "small cap" is frequently associated with high tech or emerging growth companies, these companies comprise only a segment of the small cap universe. Like the large cap universe, the small capitalization sector of the equity market includes a variety of different types of companies in a variety of different industries, many of which are financially sound, well managed and profitable.

Two years later, Mass Mutual began to test its small cap theory by

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Managers vs. the S & P 500
Annualized Total Rates of Return
(cumulative periods ending 12/31/84)

	10 years	5 years	3 years	2 years	1 year
SEI Median Manager	15.2%	14.6%	14.9%	10.9%	1.6%
S & P 500	14.8	14.7	16.6	14.2	6.3

Small Cap Stocks vs. the S & P 500
Annual Rates of Return

	'75	'76	'77	'78	'79	'80	'81	'82	'83	'84
Small Cap Stocks*	52.8	57.4	25.4	23.5	43.5	39.9	13.9	28.0	39.7	−6.7
S & P 500	37.3	24.0	−7.2	6.6	18.6	32.7	−5.0	21.6	22.6	6.3

GROWTH OF $100

	5 years	10 years	25 years	50 years
Small Cap Stocks*	$266	$1,419	$3,342	$134,617
S & P 500	200	390	756	17,883

(all periods through 12/31/84)

Comparison of Portfolios
Risk and Return
10 years (1975-1984)

	S & P 500	Small Cap Stocks*	50% S & P 500/ 50% Small Cap Stocks*
% Return	14.8	30.4	22.6
% Risk	15.1	19.1	15.8

*Source: Stocks, Bonds, Bills and Inflation: 1984 Yearbook, Chicago: R. G. Ibbotson Associates, Inc., 1984

Four-Year Performance Results
Small Cap Portfolio

	1981	1982	1983	1984
Mass Mutual Small Cap Portfolio	20.9%	47.2%	45.2%	14.2%
SEI % Ranking	1	1	1	4
S & P 500	−5.0	21.6	22.6	6.3

constructing and managing a portfolio of small cap stocks in its general investment account using the same risk-averse strategy successfully applied in its "core" equity account for the past 11 years. We sought to outperform the S&P 500 and to rank in the top quartile of equity managers in the SEI universe. Since 1981, we have exceeded all of these objectives without a significant increase in risk or variability. We ranked in the first percentile in the SEI universe in 1981, 1982 and 1983 and in the fourth percentile in 1984. Since its inception, the standard deviation of our small cap portfolio has been only slightly greater than that of the S&P and significantly less than the variability normally associated with small cap portfolios.

As a result of this portfolio, we feel that while high tech and emerging growth issues are appropriate for some pension portfolios, many plans prefer a lower risk investment strategy. Many pension plan sponsors are therefore leaning toward investment managers that apply a value-oriented, risk-averse approach to small cap investing.

Value-oriented managers use fundamental research techniques to identify high quality, smaller capitalization issues. They strive to isolate companies with a unique product, market position or operating characteristic that sets them apart from their competitors and allows for above-average rates of return. They set high standards for judging a company's potential for profitability, dividend growth, and price appreciation, as well as quality of management. In addition, they seek to purchase these companies when they appear historically undervalued.

Before selecting the most appro-

Continued on page 39

How well do ESOPs reward employees?

Most of the literature on employee stock ownership plans focuses on the effects on corporations. But how do employees fare?

In just a few years, employee stock ownership plans (ESOPs) have gone from obscurity to celebrity, from small firms on Main Street to giant conglomerates on Wall Street. They have been hailed by groups as diverse as the Democratic Party, the Steelworkers, the Chamber of Commerce, and the Catholic Church, and criticized by such unlikely allies as *Business Week* and the International Association of Machinists. In the popular perception, ESOPs are usually viewed as a means to save failing firms or restructure large public companies to make them less vulnerable to takeovers. In fact, these uses account for only about two percent of the 7,000 ESOPs covering 10,000,000 workers. ESOPs are much more commonly used in midsized, profitable companies as an additional employee benefit, a means to buy out a retiring owner, or a way to borrow money more inexpensively.

Almost all of the literature on employee ownership focuses on how it can be used to accomplish various corporate financial objectives. The remainder looks at such things as employee ownership and corporate performance or the relationship between employee ownership and employee control. Curiously, however, one would search in vain to find out just what the financial impact of ownership is on employees, the people ESOPs are supposed to benefit. ESOPs were designed primarily as a means to broaden the ownership of wealth. All of the various tax incentives ESOPs receive were created to encourage companies to share ownership with employees. So the principal evaluation of how well ESOPs are working should not focus on corporate profitability, on how well ESOPs fit into corporate financial planning, or whether ESOPs create more democratic corporations. All of these are ancillary issues. The key question about ESOPs is, as Congressman J.J. Pickle, D-Tex., pointed out recently, "how much they put in the pockets of employees."

To address this question, the National Center for Employee Ownership, a nonprofit research and membership organization, studied the actual experience of employees in over 140 representative ESOP companies. Our results, in brief, indicate that employees do quite well. An employee earning the 1983 median wage of $18,000/year would accumulate $31,000 in stock after ten years and $124,000 over 20. While these figures compare favorably to other kinds of employee benefit plans, there is no evidence that employees actually give up pension plans or wages to get their ESOPs.

by **COREY ROSEN**
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and **JONATHAN FELDMAN**
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How ESOPs work

ESOPs are a kind of qualified employee benefit plan. In an ESOP, a company sets up a trust and makes tax-deductible contributions to it, either of its own stock or cash to buy stock. Alternatively, the ESOP can itself borrow funds to buy company stock. The company would pledge to the lender that it would make contributions to the ESOP equal to the loan repayment schedule.

Stock is held in the trust and allocated to employees, following the same nondiscrimination rules that apply to other employee benefit plans. The allocations are subject to vesting, which usually starts after

Average Employee Stock Accumulation in ESOPs

Salary level	Number of years worked 10	20	30
$11,792	$20,370	$ 81,033	$261,682
18,058	31,195	124,092	400,733
27,277	47,121	187,443	605,316

Number of employees in sample: 108
Mean annual contribution as percent of pay: 10.07%
Percent annual change in stock value: 11.53%

two or three years and gradually increases to 100 percent after ten. Employees pay no tax on the stock while it is in their accounts, and only limited tax when they receive the stock at separation or retirement (usually whichever comes first). Employees in publicly held ESOPs must be able to vote on all issues; in privately-held companies, they are only required to be able to vote on issues which require more than a majority vote.

ESOPs have a number of uses. Retiring owners can have the company make tax-deductible cash contributions to buy out their shares, and can then avoid capital gains taxes on the sale by reinvesting the proceeds in the stock of other companies (but only if the ESOP owns at least 30 percent of the shares). Companies borrowing through an ESOP can deduct the contributions they make to repay the loan, meaning, in effect, that they are deducting interest and principal on the loan. Moreover, banks can deduct 50 percent of the interest income they receive on ESOP loans, which has lowered interest rates by 15 to 20 percent. Companies can also simply print new shares and issue them to the ESOP, deducting their value (within certain limits). Less typical uses include using an ESOP in lieu of wages, to buy a failing firm, and to buy or divest subsidiaries.

What an employee gets

To find out how much the average employee gets upon leaving an ESOP, we collected data from nine consulting firms across the country. The consulting firms are among the largest specializing in ESOPs, thus providing a large population base from which to draw the sample firms. We followed this approach because there are no reliable lists of ESOP firms from which to draw a sample and because firms are reluctant to divulge financial data to researchers (a phone survey revealed a very low and possibly skewed response rate to our questions). Consultants, on the other hand, could provide data for individual firms without identifying the companies. They were instructed to draw a random sample of their clients, which we have no reason to believe would differ from ESOP firms generally, since most of these firms would use a consulting firm with expertise in ESOPs to set up or administer their plan.

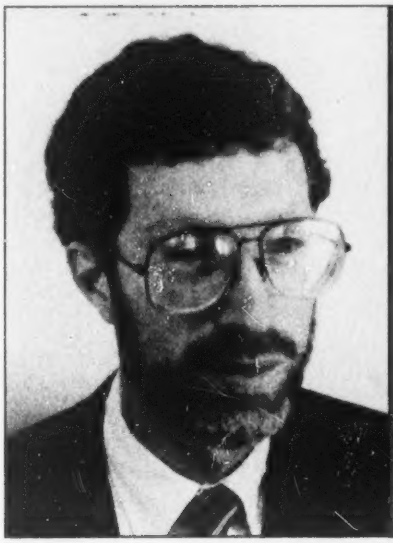
For a random sample of their clients, we asked the consultants to provide information on (1) the average annual stock price change from 1980 to 1984 and (2) the average percent of covered payroll contributed annually to the ESOP during the same time span. With these two pieces of information, we could calculate how much a hypothetical employee would accumulate in an ESOP, assuming that these same levels of contributions and stock price changes continued for the period of time (ten years, twenty years, etc.) being studied.

We used this procedure to determine how much employees at various salary levels would accumulate in an average ESOP account over ten, twenty and thirty years. This procedure assumes employees receive no additional contributions through forfeitures (stock redistributed in the plan from employees who leave before they are fully vested), and that an employee stays with the plan long enough to become 100 percent vested (usually ten years, but sometimes less). Employees who leave earlier receive only the vested portion of their accumulated benefits.

The nine consulting firms each provided data for as few as six and as many as 16 companies. In all, they provided us with contribution data for 102 firms and stock price data for 108. In evaluating the numbers provided by the ESOP consultants, we used two different control groups. First, we used data provided by companies in a National Center for Employee Ownership (NCEO) study of 37 ESOPs with characteristics similar to ESOPs in the general population. (This study focused on employee attitudes towards ownership and is reported in the book *Employee Ownership in America: The Equity Solution* from Lexington Books.) A second control group came from a random phone survey from which we were able to obtain data on eight companies. Both groups produced projected dollar accumulations in the ESOPs within 10 percent of the totals generated by the consultant groups. It appears, therefore, that the consultant sample is representative.

What did the client company data tell us about how much employees get from their ESOPs? The accompanying table shows the average contribution levels and stock price changes for the sample firms. After weighting the data provided by each consultant according to the number of companies in their sample, we found that the average company contributed about 10.1 percent of payroll to its ESOP from 1980 to 1984. The average stock price change during this period (weighted by the number of companies providing data) was about 11.5 percent.

Using these mean and median values for contribution and stock value change, we calculated account values. We found that workers at the 1983 median wage level of $18,058 would receive over $31,000 worth of stock after ten years and more than $120,000 after twenty years from their ESOP plan. The salary level for the 25th percentile of the working population was estimated to be $11,792 in 1983. Workers at this income level would receive about $20,000 from their ESOPs after ten years and about $80,000 after 20 years. Workers at the 75th percentile income level, earning $27,277 in 1983, would get about $45,000 after ten years and about $185,000 after 20 years. These projections are based on the *mean* values from the consulting companies. Using the *median* val-



"Our purpose here is not to suggest that ESOPs should be evaluated as replacements for other kinds of benefit plans, such as pensions. In fact, we have no reason to believe there is any widespread substitution of ESOPs for benefit plans."

—Corey Rosen

ues for contribution and stock price change, we found that a worker at the median income level would get about $21,000 after ten years and more than $65,000 after 20 years from an ESOP.

These projections of employee wealth, of course, would be affected by inflation and changes in real wage levels. An increase in real wages would push the values up; a decrease would force them down. Stock price changes were for the 1980-1984 period, a time of relatively low inflation. Nonetheless, the real value of the stock price increases is less than the nominal values given here.

What about other plans?

One way to put these numbers in context is to compare the performance of ESOPs with other ERISA-governed defined benefit and defined contribution plans, as well as with equity investments generally. Our purpose here is *not* to suggest that ESOPs should be evaluated as replacements for other kinds of benefit plans, such as pensions. In fact, we have no reason to believe there is any widespread substitution of ESOPs for benefit plans. Nonetheless, the findings reported here are, we think, easier to interpret if put in the context of other benefit plans and capital accumulation generally in American households.

Over the period 1980 to 1984, for instance, the Dow Jones Average grew at 6.73 percent per year (based on the closing average for each year), while the average stock price change for our ESOP samples was 11.5 percent. Pension fund managers using a mixed equity and bond investment approach, by contrast, achieved a rate of return of 12.8 percent, just above the ESOP average, according to the Employee Benefit Research Institute. The average percent of pay contributed to all types of ERISA-governed plans was six percent between 1980 and 1983, according to a Chamber of Commerce study. The average contribution to profit sharing plans among members of the Profit Sharing Council, a lobbying group, was 9.0 percent from 1981 through 1983. This figure is probably higher than the figure for all profit sharing plans, however, because it includes primarily members of a lobbying organization (those firms more interested in profit sharing, in all likelihood).

Overall, these data indicate that ESOPs compare favorably with other employee benefit plans. We could, for instance, use the model employed earlier and take the average contribution level and the average rate of return for all benefit plans. With a six percent contribution level and the 12.8 percent rate of return for balanced pension funds, an employee earning the median wage would accumulate $19,765 after ten years. This compares to just over $31,000 for the ESOP. This comparison is only heuristic, of course, since these plans work in different ways. It does give us an idea, however, of how quickly benefits accumulate in ESOPs and other kinds of benefit plans. It should be noted that these comparisons do not take into account different levels of risk in these plans. For the most part, ESOPs are riskier, and therefore should offer a higher rate of return.

In comparing ESOPs to defined benefit plans in particular, it is important to recognize that ESOPs and other defined contribution plans would normally be preferable for younger, more mobile employees, while pension plans would normally be more attractive for older employees or those planning to make a career with a single firm.

It is instructive as well to compare the ESOP figures with other measures of wealth accumulation. The median financial assets of a family headed by someone 45-54 years of age (excluding home equity) amounted only to $4,131 in 1983; the mean figure was $23,000. For families at retirement, the figures were $11,400 and $65,339. Clearly, by comparison, even a relatively short stay in an ESOP provides a larger accumulation of financial assets than most families save from all other sources.

What employees give up

What do employees give up for an ESOP? This is, unfortunately, a difficult question to answer with precision. A 1983 survey of members of the ESOP Association, for instance, revealed that only three percent of the firms required an employee contribution to the plan, and only seven percent terminated a pension plan when they set up their ESOP. In the NCEO's four-year study of 37 ESOP firms, only one company required wage concessions for their ESOP, and all of the other firms appeared to pay competitive wages or better. The 3800 employees we surveyed, on the average, reported their wages were neither notably good nor bad. Consultants we contacted universally report that few ESOPs require employees to give up anything for ownership.

A common perception is that ESOPs replace pension plans. In fact, an ESOP Association survey indicated that 35 percent of the ESOP companies also have pension plans. Unfortunately, there is no way to determine how this compares with the population of similar non-ESOP companies. To the best of our knowledge, comparable data simply do not exist (there are only data based on the number of employees receiving pensions, not the number of companies offering them). On the other hand, 35 percent of the ESOP Association companies did replace their profit sharing plans with an ESOP.

If these very sketchy data indicate that employees do not give up much, if anything, for an ESOP, then how do companies afford the extra benefits? Apparently, the answer is that ESOP companies are more productive and grow more quickly than comparable non-employee ownership firms. A number of studies have shown this relationship, although none so far have been able to determine whether employee ownership causes greater financial success or greater financial success makes a company more likely to share ownership. Either way, these companies do seem to do better, which makes it easier for them to afford the extra benefit.

Conclusion

Do ESOPs provide a significant source of additional wealth for employees? That was and is the central question that must be asked in evaluating their performance. The data reported here suggest the answer is "yes." Employees who stay with the typical ESOP for more than a few years will begin to accumulate capital accounts that will grow to five or even six figures during their tenure. Just from their ESOP, millions of employees can thus expect to accumulate financial assets greater than the net financial assets of most American families. ESOP beneficiaries do not appear to give up wages to receive these benefits, although the picture is not quite as clear with respect to whether they forego other benefits. Even if they do, however, the comparative data presented here suggest that, overall, ESOPs perform better than other benefit plans and are more likely to provide at least some benefits to the typically mobile American worker.

Given this performance, it does then appear that ESOPs have been successful in accomplishing the central purpose for which they were established — to create a more equitable distribution of wealth. ☐

Corey Rosen is executive director of the National Center for Employee Ownership in Arlington, Virginia. Jonathan Feldman was a research associate with the Center.

Small cap

Continued from page 28

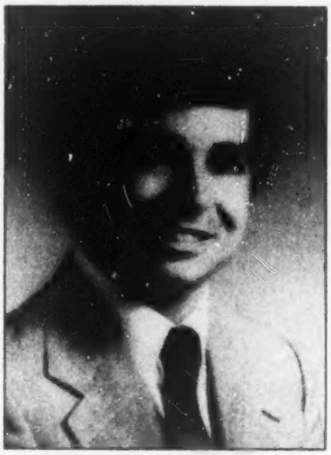
priate investment manager for your retirement program's small cap portfolio, however, there are some plan-related issues that must be considered.

First it is essential to review your plan's individual investment and risk control objectives to make sure they are realistic and compatible with your plan's needs. You must consider, for example, what rate of return is needed for plan assets to at least equal vested liabilities, and what rate of return will maintain or reduce your annual contribution rate. In addition, how much risk are you willing to assume to achieve this rate of return?

Once these issues are decided, you must consider what portion of plan assets should be allocated to the small cap market, as well as other market sectors.

Most investment managers are willing to assist plan sponsors in the asset allocation process as well as in every phase of the plan's operation — from reviewing your plan's current status to setting investment objectives to managing your fund's assets. When selecting a small cap investment manager, you should not base your decision solely on investment performance. Style, philosophy and personnel also need to be considered for a compatible, long-term working relationship.

Finally, after a suitable manager has been chosen, performance must be monitored regularly on both an absolute and relative basis to ensure that the rate of return needed to meet your plan's benefit security and cost requirements is being met within an acceptable level of risk. ☐



Leo Polverini is second vice president of investment management services at Massachusetts Mutual Life Insurance Company, Springfield, Mass. A graduate of St. Anselms College, he joined Mass Mutual in 1972. Prior to assuming his present responsibilities, Mr. Polverini was a district pension representative for Mass Mutual in Philadelphia and Pittsburgh and most recently was his company's regional pension manager in Boston.

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YMCA Retirement Fund Automates Its Reports

How Well Have Institutional Portfolios Performed?

Software Update

Pension World

March 1986
Volume 22 Number 3

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International Pension World

United Kingdom considers Additional Voluntary Contribution plans

by **VINCENT J. SIMONE**
Managing Director
IMFC, Limited
Farnham, Surrey, England

As an American working and living in the U.K. since 1977 as an employee benefit and compensation consultant, I felt the need to respond to the article, "Do defined contribution plans make sense abroad?" [International Pension World] in the June 1985 issue of *Pension World.*

It appears to me that the authors, two U.S.-based international consultants, are suggesting that "more and more [U.S.] companies are considering the use of defined contribution retirement plans as either a supplement to or a replacement for defined benefit pension plans." They say that "a combination of persistence and, most important, excellent communication to local management and employees will lead to the successful establishment of [defined contribution] plans that are workable and well received by employees [in Europe]."

In their article they examine the possibility for establishing salary reduction 401(k)-type plans in the United Kingdom and Germany. At this time I shall only comment on their remarks about the U.K.

We in the U.K. are not adverse to the "exportation" of concepts and other ideas from the States. As a matter of fact, we even get "Dynasty" and "Dallas" on our television screens.

Their article mentions the fact that there is an opportunity here in the U.K. for employees to contribute up to 15 percent of pay to additional voluntary contributions (AVC) under Inland Revenue-approved retirement plans ("schemes" are what we call plans in this country). They did omit the fact that there is also available an opportunity in the UK for salary sacrifice plans with Inland Revenue approval which is also very rarely taken up in the U.K. (I will not go into salary sacrifice plans in the U.K. at this time.)

Average Contribution Rates for Pension Schemes

	Staff Schemes	Work Schemes	Combined Schemes
Employer			
Noncontributory schemes	17.2%	6.8%	16.0%
Contributory schemes	12.0	7.3	10.5
Employee	4.5	3.6	4.6

The average U.K. pension scheme member already contributes between 3.6 and 4.5 percent of pay, and U.K. employers are already making substantial contributions to pension schemes.

I would now like to return to their comments on AVCs. They indicate that although most approved plans offer the AVC option, "the participation rate is often less than five percent because the majority of lower-paid employees cannot afford to contribute to a voluntary plan." They suggest that "to improve participation—and encourage middle-level and lower-paid workers to save—companies could offer to match employee contributions." It is the term "save" that I believe the two gentlemen may have misunderstood in suggesting AVCs.

Before going on to the point about savings, let's look at the "1984 Tenth Annual survey of Occupational Pension Schemes" by the National Association of Pension Funds, which covered companies with approximately 6.9 million employees, 4.9 million of whom were members of pension schemes. This survey indicates that 89 percent of the schemes surveyed allowed members to make additional voluntary contributions (AVC) but that only eight percent of members of such schemes made voluntary contributions.

Now let's return to that word "save" and the suggestion that the employer match employee contributions to improve participation. Again returning to the NAPF survey, we find that unlike the U.S., where I believe the majority of pension plans are non-contributory, in the U.K. 79 percent of all schemes surveyed (covering 89 percent of all members) employees were already contributing. The average contribution rates, expressed as a percentage of salary, were as shown in the accompanying table. As can be seen from the table, the average U.K. pension scheme member already contributes between 3.6 and 4.5 percent of pay—not to mention the fact that U.K. employers are already making substantial contributions to pension schemes. In my view, the U.K. employer must be competitive in world markets and would not wish to increase his costs at this time by matching AVC employee contributions.

Another point that should be

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mentioned is the fact that about 63 percent of all personal savings in the U.K. is already in the form of contributions to pension and life insurance funds and 32 percent goes into house purchase.

Now let's return to the point about using AVCs as "savings." It is true that AVCs are tax-efficient as contributions by the employee are made from before-tax income, subject to a contribution limit of 15 percent of taxable income, and that invested assets also accumulate free from all forms of taxation.

Having said that, I note that three very important features, which in my view make AVCs unattractive as a "savings" vehicle, were omitted from the June 1985 article.

1. It is a requirement of Inland Revenue that a member's contribution, once established, *must* be maintained at a fixed rate (in monetary terms or fixed percentage of salary). The rate can be raised up to the maximum but *cannot* be lowered or stopped within five years from the date the plan was begun or last amended, except in the case of genuine financial hardship.

2. AVC benefits *must* be drawn at the same time as standard benefits. This means of course that AVCs are *only* available at retirement—either early or normal.

3. The maximum benefit that Inland Revenue normally will approve includes any benefit purchase by AVCs.

I believe we here in the U.K. may welcome "savings plans," but most of us are convinced that at the present time no "combination of persistence and, most important, excellent communication to local management and employees will lead to a successful establishment of [AVC] plans" in the U.K.

Although some people here in the U.K. may welcome "Dynasty" and "Dallas" as "exports" from the States, we do, however, question whether AVC is the correct approach to savings plans in the U.K. ☐

(Mr. Simone reports that under new legislation proposed in the U.K., all private pension schemes must *permit members the opportunity to elect Additional Voluntary Contributions. The legislation is part of the U.K. Government's attempt to reform its Social Security system.—Ed.)*

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Index Futures and Index Funds: The New Investment Marriage

Pension World

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Cover: **The Chicago Board Options Exchange's market maker system requires traders to compete for order flow, as shown here in the S&P 100 (OEX) pit. This competition translates into liquidity in competitive prices. Photo courtesy of the Chicago Board Options Exchange.**

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International equities' dilemma: how do you top 1985?

Equitable's International Fund manager is bullish, but last year will be tough to beat.

Without a doubt, 1985 was a "stupendous" year for international equities and those pension funds which were in on the run-up, which averaged 56 percent, are still counting their cash. But the banner results chalked up last year leave pension managers with an interesting dilemma this year: Has the moment come to cut and run or should they hold fast for further stock gains?

This sharp jump in equity prices presents an even greater dilemma for plan sponsors who have not yet made the leap into foreign equities. Many shied away from foreign investment during the 1981-84 period because of the rise in the value of the dollar and then missed the 1985 explosion. Now they are wondering if a major thrust into international equities would yield profits or run smack into a big correction.

John F. Norris, vice president-pension operations for Equitable, who manages the firm's new International Fund, says the fundamentals of international equities remain strong but he sees no repeat of 1985's performance.

"The performance of the market," explains Mr. Norris, "has created an interesting situation for international fund managers. By no means do we expect a repeat of 1985 performance. We also feel that the fundamentals are very strong and there should be a further increase in foreign equity prices—along with some periods of declining prices. In the continental European market, we are in the state of correction from the peaks which were reached in early 1986."

Mr. Norris stresses that the overall fundamentals continue to be strong for all equity markets. He says that the reduction in oil prices is very bullish for both real growth and low inflation in the major industrialized countries. It is also helpful to other oil importing countries. The estimated impact on real growth is anywhere from one-half to one percent in real growth over and above what would have happened if oil prices had remained where they were.

"The impact on inflation also ranges from one percent to two percent," he stresses. "It is quite possible that in low inflation countries like Germany and Japan, there might be a negative inflation. Sharp declines in wholesale prices are expected in 1986, ranging anywhere from five percent to eight percent." As bullish as a fall in oil prices is for the industrialized countries and the world economy, the oil producing countries such as Mexico have serious problems, he says.

Mr. Norris' bullish outlook for international investment does not rest with falling oil prices alone. He sees the U.S. dollar falling further against the hard currencies such as the deutsch mark, the Swiss franc and the yen.

by **RONALD DERVEN**
Contributing Editor
New York, N.Y.

Further, he sees corporate profits increasing in the year ahead. Consequently, with the same price-earnings ratios that existed in early 1986, he sees a possibility of stock prices increasing 15 to 16 percent rather than eight or 10 percent on a local currency basis. On top of that, add three to four percent due to an overall weaker dollar, and it is possible to add between 15 and 20 percent to the price of a stock this year.

Last year was a banner year for foreign equity markets, according to Mr. Norris. The so-called EAFE Index—Europe, Australia and the Far East—rose by 56.8 percent in terms of U.S. dollars and that outperformed the S&P, which was up by 31.7 percent.

"This is the best return that has been recorded," says Mr. Norris. "Most every expert in this area would say that this kind of performance will not be repeated in 1986 or the foreseeable future." Mr. Norris asserts that some of the gains were actually "stupendous," as can be seen in the accompanying table.

Why the big rally in international equities? Mr. Norris says that about half of the 56.8 percent gain in the EAFE Index stemmed from the depreciation of the U.S. dollar against foreign currencies. He says that the European economies have also been in the process of a structural change in the last several years leading to more emphasis on incentives for business and less emphasis on social welfare.

"This has led to a reduction in inflation to levels which have not

"International investment is a widely accepted. . .means of asset diversification. It is only when plan sponsors have the confidence and knowledge of foreign markets that they take seriously their investment in international equities."
—John F. Norris

been experienced in more than 10 years, a pickup in real growth and a substantial increase in corporate profits," he contends. "There is more structural change going on in Europe than Japan....but then more structural change was needed in Europe.

"Money flowed out of the Far East—including Japan—and into Western Europe, particularly the continental markets. And finally, U.S. investors began flooding the European markets with U.S. dollars—particularly in the last half of 1985. This caused a rise in prices which went beyond the fundamentals. It was not uncommon for share prices to rise by five percent or 10 percent in a single day."

The Japanese market, says the Equitable executive, did not do as well in 1985, at least in terms of local currency. It was only up by around 15 percent. Although the sharp appreciation of the yen against the dollar helped the returns in terms of dollars, the lackluster return in terms of the yen stems from the very substantial run-up in prices in 1983 and 1984. Some sectors, such as the banking and insurance groups, doubled or tripled during that period, so by 1985, with stocks overvalued, there was no place for them to go but down.

International Equity Returns—
U.S. Dollar Versus Local Currency
(Capital International Indices)

	12 Months to 12/31/85		5 Years to 12/31/85	
	U.S. $	Local Currency	U.S. $	Local Currency
U.S. (S&P)	31.7	31.7	99.0	99.0
EAFE	56.8	28.6	108.3	N/A
Europe				
United Kingdom	53.4	22.9	65.2	206.3
Germany	140.9	86.9	200.4	274.8
Switzerland	108.9	65.5	107.7	140.9
France	86.9	45.4	87.1	210.0
Italy	135.2	109.3	94.1	249.0
Netherlands	62.3	25.8	151.2	225.3
Belgium	84.2	46.5	163.7	351.3
Norway	70.7	41.9	69.2	175.9
Denmark	62.2	28.3	128.7	238.7
Sweden	58.5	33.9	223.6	459.2
Spain	57.0	39.1	66.7	222.9
Austria	178.7	115.9	88.5	133.5
Pacific Basin				
Japan	43.9	14.6	142.0	138.4
Australia	21.0	48.4	−2.4	88.8
Hong Kong	51.6	51.3	0.7	54.0
Singapore/Malaysia	−22.0	−24.8	−25.9	−25.5

Another reason for the less than stellar performance was the increasing threat on Japan's exports by major industrialized countries—particularly the United States. This hit the electronics sector very hard, particularly the semiconductor industry. There were general fears about the impact on the overall economy of a stronger yen.

"Hot" sectors

There are certain industrial sectors which should benefit greatly from falling oil prices, lower interest rates and lower inflation. Mr. Norris says that they include refiners, electric utilities, financial institutions, retail stores and others.

"It will be harder to do well in international investment," he says. "We think that much more attention will be focused on stock picking and selections this year. Fund managers need to pick out issues which have under-performed the market and offer good value in terms of price-earnings ratios and have demonstrated reasons why their earnings should continue to increase."

Large cap stocks

The run-up in foreign markets in 1985, he says, was fueled by the jump in large capitalization stocks. "If one looks at the top five or 10 companies in each of the major markets, you find that they contributed a very substantial portion of the overall rise in the country's equity prices during 1985."

He says for a fund manager to outperform the market in general in 1986, he will have to look beyond the larger cap stocks to more medium- and smaller-sized capitalization issues. "That is where it is going to be very important to have analysts and portfolio managers on site in the country."

He says the best performance in 1986 in the international arena will probably be turned in by active rather than passive management. Although it is difficult to characterize the European markets as a whole, in terms of local currencies Mr. Norris feels they will be up by 10 to 15 percent and in dollar terms by 15 to 20 percent. The French market will likely be one of the better performing markets in 1986. Germany could well experience a correction and then show good gains thereafter.

Political considerations

Asked if there are any political considerations which need to be addressed when investing internationally, Mr. Norris maintains that as long as a plan sponsor concentrates on major markets and major industrialized countries in Western Europe, Japan and the Pacific Basin, there are probably no earth-shaking developments which will occur.

"It is when you get outside of these major industrialized countries that the political situation does become very important," he says. "When you invest in less developed countries, then you are really rolling the dice. We don't recommend investing in exotic countries, at least not for pension plans."

Pension funds

Mr. Norris says that international investment has been heavily used by the large pension funds. But he asserts, interest has been filtering down from the giant plans to the more medium-size plans.

"International investment is a widely accepted and long accepted means of asset diversification," he says. "It is only when plan sponsors have the confidence and knowledge of foreign markets that they take seriously their investment in international equities."

Currently, he says, plan sponsors who are investing internationally are targeting 10 to 12 percent. But many plan sponsors are raising that from 12 to 15 percent. It could reach 20 percent in the next five to 10 years as the foreign markets become more mature and as they deregulate their markets as the U.S. has done.

Mr. Norris sees a tremendous increase in the interest of plan sponsors to invest internationally. In fact, there has been an 80 percent increase in international risk assets in 1985 from $15 to $27 billion—that's pension money invested internationally.

Equitable's funds

Equitable created its new International Fund in 1985 utilizing a multi-portfolio, multi-manager approach to international investing by pension funds. Mr. Norris says that the International Fund combines the regional expertise of prominent overseas investment management firms with Equitable's knowledge of domestic markets. This approach includes exposure to small and medium capitalization companies.

Three separate equity portfolios are included in the International Fund. Two of the portfolios are "region-specific"—one in Europe and one in the Pacific Basin. These region-specfic portfolios focus on small and medium firms. The third portfolio, which invests in both of these regional markets, focuses on large capitalization companies.

Daiwa International Capital Management Co., Ltd. of Japan manages the Pacific Basic portfolio. The company manages over $4.9 billion in assets, with approximately $2.6 billion from non-Japanese clients. Schroder Capital Management International, which has $700 million under management, runs the European portfolio.

Equitable Investment Management Corporation (EIMC), a wholly-owned subsidiary of Equitable, manages the third portfolio. The subsidiary has approximately $7 billion in assets currently under management and has extensive global industry research capability, says Mr. Norris. Equitable itself has over $50 billion in tax-exempt assets under management.☐

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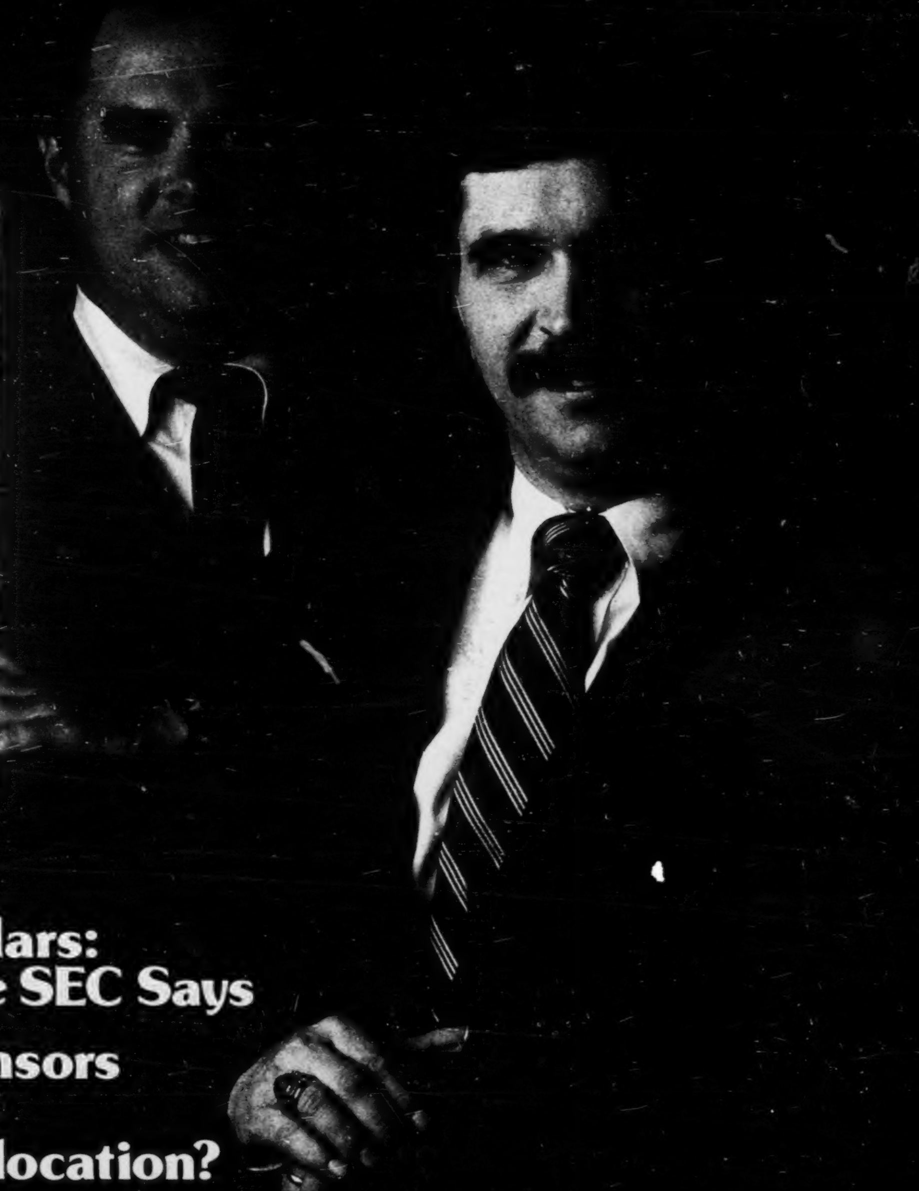
MONY's Multi-Manager Style

MONY's Joseph S. Masterson
and Phillip Maisano



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Soft Dollars: What the SEC Says

Are Sponsors Afraid of Asset Allocation?

Pension World

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***Cover:* Photo of Mutual of New York's Joseph S. Masterson, divisional vice president, and Phillip Maisano, vice president, by Jeff Weiner. Ronald Derven's profile on MONY's investment services begins on page 20.**

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Why invest in GICs at today's interest rates?

How does a plan sponsor justify 7-9 percent GIC returns to participants when other investments yield more?

by **MICHAEL L. HOOVER**
Assistant Vice President
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Richmond, Va.

With the New Year's parties over, investors awoke to a long-forgotten investment scenario—single-digit interest rates. As the stock and bond markets bulled ahead, interest-rate-based investment alternatives, certificates of deposit, money market funds, and guaranteed insurance contracts lost their attractive yields which in the past had been competitive with the long-term returns of the equity and bond markets. For the GIC buyer the question has become "How do I cope?"

While rates were soaring in the early 1980's, GICs were bought for their alluring high returns which could be locked in for the duration of the contract, up to 10 years. GICs also provided stability for the plan sponsor, following the tumultuous bond market of the late 1970's. Principal is always maintained in the GIC since it is carried at par. Imagine buying a 19.7 percent five-year GIC in 1980 and receiving a 146 percent return on your initial investment in 1985!

The early 1980's saw the rapid growth of the 401(k) participant-directed plan. For both the participant and plan sponsor alike, the GIC has offered a superb opportunity for the fixed income option—a guaranteed rate of return and no loss of principal. GICs emerged as one of the most popular investment alternatives, with upwards of 70 percent of employee dollars favoring this option. The plan sponsor's headaches were minimized as well—when participant accounting statements were distributed negative returns were no longer an issue. In most instances, the participant knew what his returns would be before his investment choice.

A new problem

Since late 1985, the plan sponsor has experienced a new problem—explaining the 7-9 percent GIC returns and justifying this vehicle in light of 11+ percent returns reported from other fixed income investments. To solve this dilemma, it is helpful to consider two key aspects—the inherent qualities of the GIC and an "active" investment strategy for the portfolio.

Why were GICs selected in the first place? They had attractive yields well above money market investment alternatives. Traditionally, GICs at a three-year maturity have offered returns roughly 200 basis points above money market funds. The contracts can provide the same degree of portfolio liquidity and the return is locked in for the duration. During the growth period of 1983 and 1984, available GIC returns remained fairly stable and the participant did not see himself losing ground in terms of absolute returns. GIC rates generally held in the 11 to 13 percent range for a three-year maturity.

However, those days are gone. The participant now faces much lower absolute returns. The accompanying chart helps to clarify this point with its average three-year GIC quotes. Generally, rates peaked in mid-1984 at 13.03 percent and reached an all-time low of 8.27 percent in the first quarter of 1986. During this same time period, the spread between GICs and comparable maturity U.S. Treasuries has ebbed and flowed but generally remained fairly stable at 55 basis points for a three-year contract.

Real returns

While historical yields speak for themselves, a more substantive relationship exists when real returns

Comparison of Historical GIC Relationships

	3 Year Avg GIC		5 Year Avg GIC	
	Contract Rate	Real Return	Contract Rate	Real Return
1983				
1st Qtr	11.06%	9.69%	11.65%	10.28%
2nd Qtr	10.86%	4.45%	11.52%	5.11%
3rd Qtr	11.90%	6.94%	12.37%	7.41%
4th Qtr	11.86%	9.61%	12.35%	10.10%
1984				
1st Qtr	11.83%	7.11%	12.38%	7.66%
2nd Qtr	12.89%	9.13%	13.42%	9.66%
3rd Qtr	13.03%	8.41%	13.39%	8.77%
4th Qtr	11.43%	10.42%	11.94%	10.93%
1985				
1st Qtr	11.01%	6.10%	11.69%	6.78%
2nd Qtr	10.19%	7.45%	10.88%	8.14%
3rd Qtr	9.74%	5.91%	10.45%	6.62%
4th Qtr	9.27%	8.17%	9.93%	8.83%
1986				
1st Qtr	8.27%	8.27%	8.77%	8.77%

> *"Participants can be assured, at least for the time being, that attractive real returns are still being earned."*

are reviewed. The chart also shows this relationship. Real returns are simply the average contract rate minus the rate of inflation. Since the purchase of a GIC is an instantaneous decision, the comparison has been made using a short-term moving average of the Consumer Price Index. No doubt better returns could have been achieved at various points in time, but real returns have generally been, for a three-year contract, in the 6 to 10 percent range, averaging 7.7 percent. Currently, real returns tend to be at the upper end of the scale, using the example of a three year GIC. The same relationship also holds true for five-year issues. Participants can be assured, at least for the time being, that attractive real returns are still being earned.

But what happens if inflation begins to erode this real return or rates rise and make the current returns unattractive? Both situations can be dealt with if the plan sponsor puts together an effective investment program for GICs which ensures flexibility for the future. For those plan sponsors who must report a rate in advance, the shorter-term window contracts currently are the most popular. (Remember, a window contract accepts deposits for a period of one year followed by a holding period of one to four years). Maturity selections tend to be at the two- and three-year level. Some windows are being written at very short maturities—six months to a year. Obviously, many plan sponsors are betting that rates will be higher in the near term and they can again lock into higher returns for extended terms. A key factor also is that the market is not offering a premium for extending to the five- and six-year maturities as once was the case. Participants should understand that while this year's contract rate may seem relatively unattractive several favorable points can be made about this investment option. First, management is opting for shorter-term contracts in order to better manage the funds. Second, a new contract is written each year. If rates rise, next year's deposits will earn at improved levels. In these situations, participant communication is an important ingredient for maintaining acceptance of a GIC-based option. Psychologically, though, it is still difficult to lock into an 8.25 percent annual return for three years when 11 percent could have been had as recently as one year ago.

Blended returns

For those plan sponsors who can report a blended return, an individually tailored investment pool can be created with GICs, minimizing the current rate shock. Averaging of returns will lessen the decline and indicate a greater perceived stability of the investment returns in the fixed income option. Flexibility and positioning for the future are key attributes to this more active investment strategy. Instead of using one window contract to accept maturing contracts and new contributions, combinations of bullet, window, participating, and indexed contracts can be utilized to structure the investment portfolio.

Each contract type offers its own advantage in this scenario. Bullets can be used to lock up a return if premium rates are offered. Coupon stripping and forward committing of deposits can also be undertaken with these contracts in order to hedge against further rate declines. Window contracts are attractive when it is desirable to communicate a guaranteed rate for the current year's deposits. Participating contracts offer general account money rates which reflect overall investment performance. The returns on this type of contract reflect a broader-based investment strategy and are often much higher than spot GIC rates. There is a price for this premium return, though, and it comes in the form of restrictive termination conditions. Participating contracts should be used very selectively and carefully. The most recent development has been the indexed contract which reacts to market interest rate changes on a concurrent basis. There are numerous types of these contracts either on the market or awaiting insurance commissioner approval. In any event, the earnings rate, based on a specific formula of market rates, usually changes every 30 days and remains competitive with the rates on three-year fixed contracts. Thus, the contract holder has an effective vehicle for participating in a rising interest rate environment. (Of course, downside risk also exists.) Overall, this type of strategy offers

Continued on page 46

Insurance companies aim for a new image as investment managers

The insurance industry is finally getting the numbers on its side.

> "Why in the world would anyone still have their money managed by a bank or an insurance company?" asked one pension consultant, echoing a common view in the industry.—*New York Times*, October 13, 1985.

The White House Rose Garden, Labor Day, 1974. President Gerald R. Ford signs into law the first comprehensive law regulating private pension plans in the United States—The Employment Retirement Income Security Act of 1974 (ERISA). For those of us in the pension business, life would never again be the same. The nature of the business as well as the players in this $1 trillion industry were to be irrevocably affected.

ERISA, among other things, created higher standards for pension performance, causing fiduciaries to look hard at their traditional investment vehicles and to seek the highest returns in the safest investments. In addition, ERISA spurred an evolution in investment philosophy within the investment departments of insurance companies, reflecting a change in attitude away from that of a long-term, passive, buy-and-hold investor to that of seeking new alternatives in search of a competitive real rate of return.

An insurance company's image as a professional investment manager has never been very high, either pre- or post-ERISA. Despite the best efforts of the insurance industry to polish its reputation and a good performance in investment management, it's been difficult to shake off a bad press. The *New York Times* article quoted above, for example, captured this attitude. There remains a reservoir of feeling in some investment circles that insurance companies are not places of high-performing investment management.

Changing self-perception

It's not for lack of trying, though. One major step has been the industry's changing perception of itself. During the 1980s this shifted from an insurance to an investment orientation which, in turn, led to significant efforts by insurors to establish themselves in the investment field. Expanded product lines incorporating non-guaranteed products were put in place along with the necessary support infrastructure of people and technology. Going after pension business also provided a major opportunity for insurors to protect themselves against the dramatic underwriting cycles that can impact their traditional lines of business.

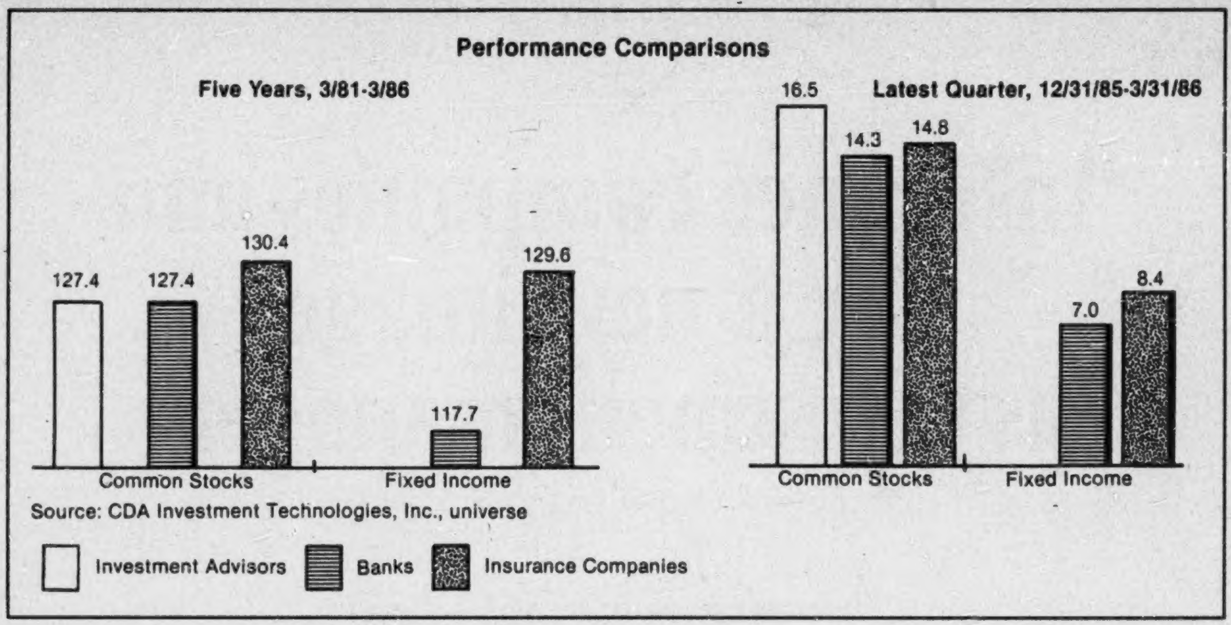
By **JON A. BOSCIA**
Senior Vice President
Lincoln National Pension Insurance Company
Fort Wayne, Ind.

Why the bad image? And how is the industry trying to change it?

Prior to ERISA, virtually all sophisticated and creative pension investment managers were employed in the trust departments of banks and in investment departments of insurance companies. With ERISA, the floodgates to independent investment management were opened, leading to the founding of a number of investment "boutiques," most of them staffed by former bank and insurance company investment managers.

To be sure, insurors had hastened the departure of some of their best people through a rather unenlightened compensation system that neither rewarded nor punished performance. Many pension investment professionals collected salaries come rain or shine in the portfolios they managed. Performance incentives were not in the insurors' lexicon.

In the post-ERISA era, insurance companies quickly came to realize



Source: CDA Investment Technologies, Inc., universe

that future successes would be dependent upon their ability to provide competitive investment products. Easier said than done, however, as attainment of these lofty goals was hampered by their inability to retain, let alone recruit, capable, creative people with the investment expertise to offer investment alternatives that clients found attractive.

Competitive pressures

To their credit, insurance companies implemented various strategies to cope with this problem. Some gave their portfolio managers an equity stake in the business. Others modified the decision-making process by giving their managers more autonomy. Still others went to employment contracts with lofty performance bonuses. To assist their portfolio managers, insurors developed a research capacity and global communications networks along with a marketing edge in name recognition and existing client relationships.

The pension marketplace today continues to be one of the most competitive markets in the financial services industry. The competition is fierce. Insurance companies face competition from other insurance companies, banks, independent investment counselors, mutual funds, investment banking firms and brokerage companies. Because of deregulation, there has been a blurring of roles in the financial services marketplace among banks, stockbrokers, insurance companies and investment counselors. Everyone wants to get into everyone else's business. New competitors and new products are emerging every day.

Pension portfolio managers, responding to competitive pressures and their new-found freedom, have instituted changes in the investment mix. Such investments as income participation, equity real estate, oil drillings, futures and options, joint venture capital, convertible private placement, interest rate swaps and publicly-traded convertibles are commonplace. In addition, there have been significant improvement and enhancement to some of the old standbys such as Guaranteed Investment Contracts (GICs), dedicated bond portfolios and guaranteed annuities, making them more responsive to today's more demanding plan sponsor.

> *"The pension marketplace continues to be one of the most competitive markets in the financial services industry."*

Turning a perceived disadvantage into an advantage, insurors are no longer defensive about their size. They assert that because of their size they have the resources to offer an array of products to meet the diverse needs of their clients. As clients have become more sophisticated in investment options, insurors have responded by involving themselves in increasingly complex products. They have become well versed in asset allocation to help their clients manage the risk/reward tradeoffs of alternative products.

Managers have become more activist and more entrepreneurial. The old days of maintaining profits and not losing money have given way to the pressures of living up to the expectations of their clients and improving the bottom-line performance of their employer. Managers are now being called upon to articulate clearly their investment philosophy and they are held accountable for performance as well. And with the increased emphasis on investment performance has come a heightened visibility—now sales successes depend greatly on their performance.

Outside consultants

Of ever-increasing importance in the pension field in the post-ERISA era are asset allocation and asset mix. In recognition of the need for new products and to enhance their own investment capabilities, insurors have hired and acquired outside investment counseling firms. On the acquisition front, there have been several notable purchases.

The *New York Times* article cited the purchase of Jennison Associates Capital Corporation by the Prudential Insurance Company of America, as well as the Equitable Life Assurance Society of the United States' purchase of Alliance Capital Management through the purchase of Alliance's parent company, Donaldson, Lufkin & Jenrette. In addition, U.S.F.&G bought E. W. Axe and Company and New York Life plunked down some $47 million for McKay-Shields Financial Management.

In our own instance, Lincoln National acquired two New York City-based investment advisory firms, Modern Portfolio Theory Associates, Inc. (MPT), and Lynch and Mayer, Inc. We have also established a joint venture with Walter Scott International Ltd., Edinburgh, Scotland, an overseas investment firm.

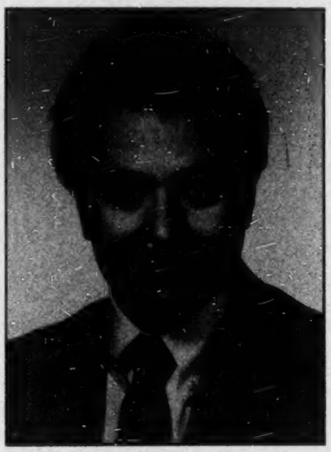
The rationale for our acquisitions might differ slightly from that of other insurors but probably not by much. We were seeking some complementary investment management firms in order to stay competitive in the investment marketplace. It's a very fast track in the investment world and the opportunity to make acquisitions of well-connected investment management organizations was too good to pass up.

Brighter future

All in all, I would submit that insurance companies are doing a good investment job these days and that our image of slow, unimaginative lumbering giants is changing. The opportunities abound. With the decline in defined benefit plans has come an offsetting surge in the establishment of new funds like 401(k) plans, IRA accounts, and savings and profit-sharing plans. The termination of overfunded plans by sponsors in order to capture the excess has also created a stream of new dollars into insurors' investment departments. Since 1980, corporations have recaptured almost $12.5 billion in excess assets while terminating over 1,100 pension plans with more than $29 billion in assets. The difference is in annuities purchased from insurance companies to cover existing pension liabilities.

To be sure, some problems remain. There is, as already noted, the poor public perception of insurors as investment managers. And the fact that competition continues to grow at a faster rate than the available investment dollars will be a continuing challenge. The resourcefulness and ingenuity of insurors to get their share of these dollars in the future will be sorely tested.

In summary, while there may not be a quick turnaround in the *image* of insurance companies as investment managers, there has been improvement in *actuality,* as the accompanying chart indicates. Insurance companies are getting their act together in the new investment environment. Internal streamlining of their pension investment departments, competitive compensation, acquisitions, a higher degree of automation to match the efficiency of the securities markets and a consistency and discipline throughout the decision-making process are among the solutions they have implemented to deal with the demands for superior results. ☐



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"That two of the hottest plan types of the 1980s, 401(k) and cafeteria plans, are predicated on individual choice is no coincidence. Employees do appreciate being able to tailor benefit choices and/or levels to their particular economic needs."

family unit has been shattered. Fifty percent of marriages end in divorce. Furthermore, roughly half of wives now work (and this percentage will keep increasing), thus increasing the number of childless couples. If the current cumulative price tag of raising a child in 1980s America is $150,000, two households can have the same total income but have vastly different economic situations due to both the difference in the number of children in their households and the increase in the relative expense of raising them.

Need any more thoughts as to how the homogeneous family unit has broken down? In 1980, a *Los Angeles Times* article used the term "mingles" to describe a combination of single and married people. Mingles were joining forces buying homes and condominiums in Southern California due to the high cost of real estate. Other pricey areas such as Boston, San Francisco, New York City and Washington, D. C. may have encountered similar trends.

That two of the hottest plan types of the 1980s, 401(k) and cafeteria plans, are predicated on individual choice is no coincidence. Employees do appreciate being able to tailor benefit choices and/or levels to their particular economic needs.

Future viability

With all these factors adversely affecting defined benefit plans, is there any hope for their future vitality?

Well, any plan that skews benefits to older and long-term employees as effectively as a defined benefit plan has got to have *some* hope, since these are exactly the two groups of employees who are most interested in a retirement program. But the issues of increasing administrative burdens, lack of employee understanding and an increasingly unfavorable legislative environment all need to be addressed for defined benefit plans to remain significant vehicles.

In these areas, I offer several suggestions to the pension community:

1. First and foremost, do not be shy about making your views on proposed legislation known *quickly* to members of both the House Ways and Means Committee and Senate Finance Committee. The advent of the word processor makes this a pretty painless task.

2. Second, the pension community needs to be made fully aware that effective lobbying takes money. Supporting a Political Action Committee (PAC) like the one established by the Association of Private Pension and Welfare Plans (APPWP) is one means to achieve this.

3. Make defined benefit plans more palatable to employees. For instance, one common complaint that I have heard at employee meetings is that a Social Security offset is perceived as an unfair "takeaway." Now, we all know this to be an untrue perception, but why not eliminate this common misperception by switching to an integrated, step-rate plan?

4. Support the concept of future pension legislation, such as the proposed Retirement Income Policy Act by Senators Heinz and Chafee, where a pension bill is on a standalone basis instead of having pension provisions relegated to a minor part of mammoth tax bills, as occurred in both 1982 and 1984. In this manner, we can have the opportunity for ample public discussion. Remember that in 1982 Congressional staffers inserted top-heavy provisions during a 12th hour mark-up session, even though top-heavy was never proposed in *any* of 1982's Congressional proposals earlier that year.

If these four suggestions are largely implemented, I believe that 20 years from now the defined benefit plan will not suffer the same fate as the Model T.

GICs

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interesting advantages, yet it can add complexity to the administrative aspects of the GIC portfolio.

Aside from making a case to the participants and developing an active investment strategy for the GIC funds, plan sponsors should always remember that GICs offer a guarantee of principal. Most high-yielding fixed income vehicles cannot claim this feature, for as yields rise principal value is lost. If asset allocation decisions are changing either at the plan or participant level, consider these choices: holding a GIC for three years and bringing out 27 percent more than deposited, guaranteed, versus moving to a bond fund where 27 percent losses have been experienced in one quarter. In general, GICs continue to outperform money market rates with three-year contracts available in the 8.25 percent range while money markets are returning 6.50 percent.

True, contract rates have declined and real returns may ebb and flow, but the preservation of principal remains. GICs continue to be a viable alternative and provide attractive real returns. Effective portfolio structuring can be utilized to maximize their potential as a fixed income investment. ☐

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401(k)s Live!

Is Tax Reform Good for Real Estate?

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***Cover:* Congress and the President have been working toward tax reform for the past year and a half. A final bill may be in sight. Photo by Keith Jewell, Office of the House Photographer.**

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401(k)s live!

Not only did a vigorous public education campaign save 401(k)s from the Congressional ax, it helped persuade more employers to establish new plans.

by **JAMES T. MATTERA**
Regional Pension Sales Director
State Mutual Life Assurance
Company of America
Atlanta, Ga.

November 26, 1984 was an important day in the short history of the 401(k) plan. On that day, Treasury officials proposed to eliminate the popular retirement savings option as part of their deficit reduction, tax reform package. The business and related trade media quickly reported the issue and warned plan sponsors of impending doom for employers who would establish 401(k) plans during that "tax-reforming" political environment.

Fortunately however, Treasury I — the most serious effort to date to eliminate 401(k) plans — proved to be about as popular as Prohibition after World War I. In the short run, Congressional discussions and anticipated legislation to wipe out the retirement savings option did discourage a few employers from adopting new plans. The proposal was defeated, however, thanks largely to a concerted public education campaign that forced a good, hard look at the program and its beneficiaries.

This apparent victory should not lull us to sleep. We in the pension and employee benefit professions should continue public education and continue to ask Washington to leave Section 401(k) in its present form.

Public education

During their public awareness campaigns, consulting organization and insurance company surveys noted that participation was diversified from the lowest to the highest paid employees in most situations, and that 401(k) plans were fast becoming the most prevalent means of retirement savings. As many as 15 million employees now contribute to 401(k) plans, and 80 percent of the nation's largest employers either already have a plan or are about to adopt one for their employees. A recent survey of 2.7 million employees participating in 401(k) plans, conducted by the Employee Benefit Research Institute (EBRI), reveals that 54 percent earned less than $25,000. Another EBRI study found that the lower-earning two-thirds of participants contributed an average of 4.9 percent of compensation, while the upper-earning one-third contributed an average of 6.5 percent.

What was once falsely viewed as a retirement savings plan that favored the highly paid, was more appropriately identified as a plan that belonged to the rank and file in greater numbers. In fact, management and labor often joined to applaud the broad appeal of 401(k) and opposed, through heavy lobbying efforts, its repeal.

This public education campaign dealt an unexpected blow to the Treasury proposal. Rather than a decrease in the number of new plans established during this time of uncertainty, employers decided that the time was right to establish new 401(k) plans or convert into 401(k) plans existing profit sharing plans that were not meeting their intended objectives. Communication programs, at a level never seen before, became part and parcel of educating employees to the advantages of 401(k) on both the long- and short-term basis. In addition to the obvious tax advantages, partici-

Table 1 **Comparison of Retirement Savings Options**

	401(k)	IRA	Regular Thrift	Voluntary Contributions	Private Savings
Maximum contribution	Up to $30,000 or 25% of earnings, subject to plan limits	$2,000 for an individual, $2,250 with spousal IRA	Up to 6% of earnings, subject to plan limits	Up to 10% of earnings	Unlimited
Federal tax treatment of deposits	Tax-deductible	Tax-deductible	Not deductible	Not deductible	Not deductible
Federal tax treatment of earnings	Tax-deferred until withdrawn	Tax-deferred until withdrawn	Tax-deferred until withdrawn	Tax-deferred until withdrawn	Taxable
Additional savings opportunities	Corporation match on contributions possible	No match	Corporate match on contributions	No match	No match
Access to funds	Withdrawals without tax penalty allowed at termination of employment, retirement, disability or death, and before age 59½ for hardship. Loans are available	10% tax penalty on withdrawals before age 59½ except for disability, death Loans not permitted	Generally distributions only upon termination of employment, disability, death or retirement Loans available	Withdrawals permitted at any time	Withdrawals possible at any time
Distribution requirements	Generally need not begin by age 70½ if individual is employed	Must begin by age 70½ if IRA. Not required if TDC	Generally need not begin by age 70½ if individual is employed	At any time	At any time
Preferential tax treatment available through 10 year income averaging	Yes	No	Yes	Yes	No

Source: State Mutual Life Assurance Company of America

pants were convinced they were contributing to their own financial security and protecting themselves against anticipated shortages in Social Security.

Public education successfully highlighted some of the following crucial points:

- participation in 401(k) plans makes it easy and convenient to pay yourself first through salary deferral;
- contributions are much higher with 401(k)s than with IRAs for many two-income families;
- matching company contributions are extremely attractive, as well as the ability to withdraw funds without penalty for hardship reasons;
- ten-year income averaging is an important tax advantage at distribution time because, through compound interest, one's account can grow to a substantial amount through systematic savings; and
- loans can be attractive features if plan sponsors are willing to accept the additional administrative work involved.

The accompanying tables compare five kinds of retirement options — 401(k)s, IRAs, regular thrift plans, voluntary contributions and private savings — and show how much an individual can save under each plan.

As a result of public education efforts, 401(k) supporters sent cards and letters to administrative and legislative officials and decision-makers proclaiming the same basic message: "Leave 401(k) plans alone." I attended a Southern Pension Conference meeting at which Senate Finance Committee Chairman Robert Packwood, R-Ore., commented that the quantity of mail received was so large that the daily count was determined by weighing the mail bags — they had actually determined the number of letters to a pound! This was additional proof of the popularity of 401(k) plans.

The success of 401(k)

One might ask: "Why was the 401(k) plan so popular as a savings vehicle in comparision to the well-publicized individual retirement accounts (IRAs) of the late 1970s and early 1980s?" There are of course many reasons, a primary one being the communication of 401(k) benefits to plan participants. This educational process took place at the employer-employee level, rather than at the seller-buyer level of the typical IRA. It was a lot less intimidating for an employee to accept the virtues of a 401(k) from his superior, for example, than an IRA solicitation from a banker, broker or insurance agent. The perception of a benefit provided rather than a product sold made employees more willing to accept 401(k)s. Participation by fellow employees at the company, including supervisors, made it prudent to jump onto the 401(k) bandwagon.

Genuine employer interest at both the economic and public relations levels also helped produce a top-down acceptance of the plans that assured widespread participation at all employee levels. It has been the norm to expect a 401(k) participation level of 70-80 percent — far greater than the 15-20 percent IRA participation.

As one of my former history professors taught me: "The truth is not often as important as what people perceive the truth to be." Tangible proof through quarterly or annual

Table 2 **Comparison of Retirement Savings Deposit**

	401(k)	IRA	Regular Thrift	Voluntary Contributions	Private Savings
Annual contribution	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 2,000
Income tax on contribution (30%)	None	None	$ 600	$ 600	$ 600
Net contribution	$ 2,000	$ 2,000	$ 1,400	$ 1,400	$ 1,400
Total net contribution after 30 years	$ 60,000	$ 60,000	$ 42,000	$ 42,000	$ 42,000
Tax treatment on earnings during accumulation	None	None	None	None	Taxable as ordinary income
Net earnings after 30 years at 10% per year	$301,887	$301,887	$211,321	$211,321	$ 99,502
Account balance after 30 years	$361,887	$361,887	$253,321	$253,321	$141,502
Tax treatment on lump sum distribution	10 year income averaging	Ordinary income	10 year income averaging	10 year income averaging	Tax free since all taxes already paid
Amount of tax	$ 91,748	$177,414	$ 40,973	$ 40,973	None
Net account balance	$270,139	$184,473	$212,348	$212,348	$141,502

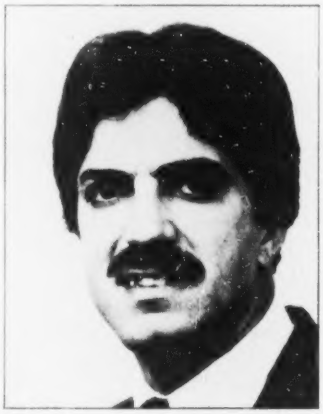
Source: State Mutual Life Assurance Company of America

employee statements provided by plan sponsors convinced employees that they had access to a real "employee benefit" program.

Traditional defined benefit plans provide a guaranteed benefit at retirement, but they have never been truly appreciated by most rank and file employees because tangible benefit evidence on a current basis is relatively meaningless to them. Annual defined benefit employee statements, for example, often show vested and projected benefits. The vested benefits are frequently low due to short service and graded vesting schedules. Therefore, the employee sees a low current benefit and a projected benefit that seems unobtainable and meaningless due to the length of time that one must work to achieve it. Defined benefit plans are also typically written on a final pay basis — the last five to 10 years of earnings — so it is difficult to determine one's eventual benefit. The "guaranteed benefit" feature of a defined benefit plan is often lost to the average participant because of the complexities of the plan. The work force has also become more mobile, lessening the appreciation of traditional plans. Vesting schedules of 10-15 years, typical in most defined benefit plans, are limited to five to six years in many 401(k) programs.

Matching employer contributions, often up to six percent of employee compensation, can be a strong motivational force to encourage employees to save for the future. It is not unusual to see relatively low wage earners contribute the maximum permitted under their "salary savings" program in order to take full advantage of the matching employer contributions. Although some employees may not understand the background or meaning of Section 401(k) of the Internal Revenue Code, they all can readily see and benefit from the results of these programs.

Profit-sharing thrift plans are not new. They have existed for many years. However, employee participation levels in these plans are much lower than in their 401(k) counterparts. This is due in part to after-tax versus pre-tax contributions, and, perhaps more importantly, employers did not promote the traditional matching plans as



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> *"It appears that very few proposals have judged 401(k) on its merits as a retirement savings program and instead have attacked it as a means to raise revenue. This intention appears obvious and could explain why 401(k) plans have been left alone to date. Sounder minds have prevailed when all aspects of the legislation and its effects on financial security were studied."*

aggressively as they have the newer 401(k) plans. One reason for this greater promotion is the need to satisfy the qualification requirements of 401(k) plans that require non-discriminating contributions between the bottom two-thirds and the top one-third of all employees in the group. This practical application of the 401(k) thrift feature grew into genuine appreciation of the employer's role in the employees' savings and security program. The matching employer contribution has taken on new meaning.

A 1985 Hewitt Associates survey compared various 401(k) design characteristics, including matching contributions, with levels of participation. According to the survey results, participation was 64 percent when companies matched employee contributions dollar-to-dollar, compared to only 41 percent when plans provided no matching contributions. Generally, matching contributions will encourage both increased employee participation and increased levels of employee savings.

The proof was there. Employees were flocking to 401(k) programs in numbers that were never seen before. Treasury officials saw the potential loss of tax dollars and thus crusaded to repeal the 401(k) provisions. This view was short-sighted, however, because various studies (EBRI, e.g.) have shown that 60-75 percent of current tax-deferred dollars become taxable in future years. This is true because people pay taxes on larger incomes as they approach retirement. After all, this program is one of tax deferral, it is not a permanent tax shelter. This is a small price — 25 to 40 cents per dollar — to pay for the economic security of the average American, especially compared to the cost of a government-sponsored retirement savings program.

Judge 401(k) on merit

Legislative proposals have gone from outright repeals (November 1984) of 401(k) plans to limitations in their provisions. There have been so many proposals in the name of tax reform that it's often difficult to keep up with the latest version. Most have included reducing the maximum contribution from $30,000 to $7,000, taxing withdrawals prior to age 59½ with a 10-15 percent penalty, and removing the availability of 10-year income averaging. It appears that very few proposals have judged 401(k) on its merits as a retirement savings program and instead have attacked it as a means to raise revenue. This intention appears obvious and could explain why 401(k) plans have been left alone to date. Sounder minds have prevailed when all aspects of the legislation and its effects on financial security were studied.

On June 23, the Senate passed 97-3 its latest version of tax reform. This time it is the IRA plan that is threatened, not the 401(k). I think this confirms the recognition that 401(k) plans are truly broad-based. IRAs are being utilized by a select group of our population, while the 401(k) has broader participation.

A 401(k) plan provides a significant retirement savings opportunity and can be adapted to meet most needs and objectives. I can only hope that our legislators will continue to recognize the 401(k) program for what it is — a valuable employee benefit. Washington should take the advice of many: "If it ain't broke, don't fix it." Section 401(k) of the Internal Revenue Code has been a blessing to many. Please, leave it alone. ☐

Real estate

Continued from page 16

We will also see more reports of foreclosures and bankruptcies of limited partnerships as they are unable to service high levels of debt incurred when properties were acquired by tax shelter syndicators. In many cases, these properties were purchased from parties related to the promoters at prices that were not necessarily arm's length and were financed at high levels to cover the purchase and to provide cash for fees payable to the promoters and others. Apartment properties are particularly involved in these circumstances. Because of their special tax treatment, they have been a more efficient vehicle for creating tax losses for sale to the public, and as a result have been both overpriced and overbuilt, especially in the Sunbelt.

But these problems are due to the 1981 tax reform, not the current one, and the retail and industrial markets will continue to show strength. We will not have to wait for the long term to see benefits to the real estate market following the proposed reforms. ☐

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Current Issues In Plan Design

Survey indicates states are holding down health plan costs

States have made great strides containing the cost of health benefit plans for their employees. Continuing commitment to health care cost management initiatives by the states has been a key factor for holding down these costs.

Martin E. Segal Company's 1986 update of its survey of state employee health benefit plans indicates that during the year ended January 1986 the increase in the average cost of state plans was substantially less than the rise in national medical care costs as measured by the Consumer Price Index (CPI). Several states reported decreases in the cost of coverage, and some have realized substantial savings as a result of the implementation of cost management programs and incentives for more cost effective health care.

In early 1986 the Segal survey was updated to reflect current contributions to the basic health benefit plans covering employees of all 50 states and the Virgin Islands. The three 1986 update tables show contributions for January 1986 and January 1985 for employee only coverage (Table 1), employee and family coverage (Table 2), and retiree only coverage (Table 3). In addition, the tables provide information on the percentage of the total cost paid by each state for the three types of coverage.

The 1986 update tables present contribution data for basic plans and do not include the numerous HMOs offered to state employees. For states with multiple benefit plans, the tables generally show contributions for only the "low" and "high" basic plans. Figures regarding average costs for the 51 state plans, and the distribution of plans by the percentage of the total cost paid by the state, are based on the low option plan for states with two basic plans shown in the tables.

Although averages conceal the very wide diversity in state employee health plan benefits and costs, the average total cost for employee only coverage increased approximately 3.5 percent between January 1985 and January 1986; this increase was about half the 6.9 percent rise in the medical component of the Consumer Price Index (CPI) during the same period. For employee and family coverage, the average total cost for the 51 state plans increased only 2.8 percent — or by just two-fifths of the 6.9 percent rise in national medical care costs — during the year ended January 1986. The average cost of providing health care benefits for a single retiree increased by an even smaller percentage than the cost of family coverage, 1.7 percent compared to 2.8 percent.

by **JOHN P. MACKIN**
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Employee only coverage

As of January 1986, 31 states were paying 100 percent of the cost for employee only coverage under at least one basic plan. Between 1985 and 1986, the distribution of state plans by the state's share of total cost for employee only coverage changed very little. From January 1985 to January 1986, the total cost percentage paid by the state for employee only coverage remained the same in 43 states, decreased in two and increased in six. States that increased their share of the cost include: California (87.8 to 100 percent for the low option plan), Colorado (81.6 to 87.5 percent), Ohio (84.4 to 100 percent for the low option plan) and Tennessee (70 to 80 percent).

During the year ended January 1986, the total cost for employee only coverage increased in 24 states, remained the same in 17 states and decreased in 10 states. This is in sharp contrast to last year's experience, when the comparable figures were 39, seven and five.

The average total cost for employee only coverage increased to $77.73 for January 1986 from $75.13 for January 1985, a 3.5 percent gain. The average state cost increased by a larger percentage than the average total cost — to $72.80 from $69.70 or by approximately 4.4 percent — because the average state share increased to 94 percent in 1986 from 93 percent in 1985.

Twelve states pay for the full cost of health benefits for employees and their dependents. The distribution of state plans by the state's share of the total cost for employee and family coverage changed only

Table 1

Monthly Contributions to State Employee Health Insurance Plans: 1985 and 1986
Employee Only Coverage

State	Cost to employee 1985	Cost to employee 1986	Cost to state 1985	Cost to state 1986	Total cost 1985	Total cost 1986	Percent of total cost paid by state 1985	Percent of total cost paid by state 1986
Alabama	0	0	100.00	105.00	100.00	105.00	100.0%	100.0%
Alaska	0	0	184.57	222.60	184.57	222.60	100.0	100.0
	0	0	234.84	237.75	234.84	237.75	100.0	100.0
Arizona	1.00	1.00	79.46	79.46	80.46	80.46	98.8	98.8
Arkansas	23.64	25.40	55.00	62.50	78.64	87.90	69.9	71.1
California	11.90	0	86.00	85.00	97.90	85.00	87.8	100.0
	37.17	39.39	86.00	85.00	123.17	124.39	69.8	68.3
Colorado	12.00	8.12	53.12	57.00	65.12	65.12	81.6	87.5
Connecticut	0	0	84.62	89.30	84.62	89.30	100.0	100.0
Delaware	0	0	73.90	72.48	73.90	72.48	100.0	100.0
	19.44	19.06	73.90	72.48	93.34	91.54	79.2	79.2
Florida	15.18	15.18	65.20	65.20	80.38	80.38	81.1	81.1
Georgia	13.60	13.60	62.95	62.65	76.55	76.25	82.2	82.2
	26.65	26.65	62.95	62.65	89.60	89.30	70.3	70.2
Hawaii	17.36	18.22	26.04	27.34	43.40	45.56	60.0	60.0
Idaho	0	0	73.10	69.52	73.10	69.52	100.0	100.0
Illinois	0	0	77.56	75.24	77.56	75.24	100.0	100.0
Indiana	1.58	1.58	72.45	72.45	74.03	74.03	97.9	97.9
Iowa	0	0	68.24	68.24	68.24	68.24	100.0	100.0
Kansas	0	0	83.42	78.53	83.42	78.53	100.0	100.0
Kentucky	0	0	53.82	60.22	53.82	60.22	100.0	100.0
Louisiana	39.52	39.52	39.52	39.52	79.04	79.04	50.0	50.0
Maine	0	0	67.08	72.56	67.08	72.56	100.0	100.0
Maryland	10.74	10.22	60.86	57.92	71.60	68.14	85.0	85.0
	20.58	19.54	60.86	57.92	81.44	77.46	74.7	74.8
Massachusetts	9.87	10.22	88.82	91.95	98.69	102.17	90.0	90.0
Michigan	11.12	11.12	100.14	100.14	111.26	111.26	90.0	90.0
Minnesota[a]	0	0	73.00	73.00	73.00	73.00	100.0	100.0
	—	6.48	—	73.00	—	79.48	—	91.8
Mississippi	0	0	58.80	72.00	58.80	72.00	100.0	100.0
Missouri	0	0	64.00	69.00	64.00	69.00	100.0	100.0
Montana	0	0	93.70	96.20	93.70	96.20	100.0	100.0
Nebraska	0	0	41.25	41.25	41.25	41.25	100.0	100.0
	11.89	11.26	44.47	44.47	56.36	55.73	78.9	79.8
Nevada	0	0	124.20	129.20	124.20	129.20	100.0	100.0
New Hampshire	0	0	61.03	67.96	61.03	67.96	100.0	100.0

slightly between 1985 and 1986.

Almost half (22) of the states were paying less than 70 percent of the total cost for employee and family coverage. In 10 of these 22 states the state's share was less than half the total cost for family coverage.

For the 50 states and the Virgin Islands, the average total cost for family coverage increased approximately 2.8 percent, to $178.09 for January 1986 from $173.18 for January 1985. The percentage increase in the average total cost for family coverage was only about two-fifths of the 6.9 percent rise in national medical care costs as measured by the CPI.

During the year ended January 1986, the state's share of the total cost for employee and family coverage increased in 14 states, remained the same in 31 and decreased in six. Although the percentage paid by the state varies from 100 to less than 40, the average state share for the 51 plans combined was 73 percent in 1986 compared to 72 percent in 1985. The average state cost for family coverage was 3.8 percent higher in January 1986 ($130.13) than in January 1985 ($125.41).

Among the 39 state plans where employees contribute for employee and family coverage, the average employee cost was $62.71 for January 1986. In seven of these 39 states the employee's out-of-pocket cost for family coverage exceeds $100 a month.

Retiree only coverage

Table 3 shows 1986 and 1985 contributions for a single retiree age 65 or over with Medicare. Contribution data are presented for 49 instead of 51 plans, because Indiana and Nebraska do not offer retired employees the opportunity to continue participating in the state health benefits plan.

Among the states that make access to coverage available to retirees, 23 make no contributions toward the cost of retiree health care benefits. In the 25 states and the Virgin Islands where the state makes some contribution toward

Table 1 **Employee Only Coverage (Cont'd.)**

State	Cost to employee 1985	Cost to employee 1986	Cost to state 1985	Cost to state 1986	Total cost 1985	Total cost 1986	Percent of total cost paid by state 1985	Percent of total cost paid by state 1986
New Jersey	0	0	58.93	65.89	58.93	65.89	100.0%	100.0%
New Mexico	17.27	15.30	51.79	45.88	69.06	61.18	75.0	75.0
	27.63	24.48	41.43	36.70	69.06	61.18	60.0	60.0
New York	0	7.51	74.44	67.66	74.44	75.17	100.0	90.0
	9.28	9.07	83.57	83.15	92.85	92.22	90.0	90.0
North Carolina	0.25	0.26	48.05	63.82	48.30	64.08	99.5	99.6
North Dakota	0	0	50.00	60.00	50.00	60.00	100.0	100.0
Ohio	12.75	0	68.95	68.95	81.70	68.95	84.4	100.0
	25.50	25.50	68.95	68.95	94.45	94.45	73.0	73.0
Oklahoma	0	0	115.31	115.31	115.31	115.31	100.0	100.0
Oregon	0	0	70.24	72.46	70.24	72.46	100.0	100.0
—BUBB Plan	0	0	136.70	144.90	136.70	144.90	100.0	100.0
Pennsylvania	0	0	54.30	57.81	54.30	57.81	100.0	100.0
	0	0	67.05	70.50	67.05	70.50	100.0	100.0
Rhode Island	0	0	52.15	77.97	52.15	77.97	100.0	100.0
South Carolina	0	0	58.21	62.29	58.21	62.29	100.0	100.0
	6.56	7.02	58.21	62.29	64.77	69.31	89.9	89.9
South Dakota	0	0	50.72	53.42	50.72	53.42	100.0	100.0
Tennessee	20.07	11.70	46.82	46.82	66.89	58.52	70.0	80.0
Texas[b]	0	0	66.29	66.29	66.29	66.29	100.0	100.0
	0	—	86.27	—	86.27	—	100.0	—
Utah	8.25	8.25	74.25	74.25	82.50	82.50	90.0	90.0
Vermont	8.65	8.65	34.58	34.58	43.23	43.23	80.0	80.0
Virginia	0	0	65.52	71.16	65.52	71.16	100.0	100.0
Washington	0	0	64.52	64.52	64.52	64.52	100.0	100.0
West Virginia	0	0	79.95	79.95	79.95	79.95	100.0	100.0
Wisconsin[c]	9.38	12.31	69.74	72.69	79.12	85.00	88.1	85.5
Wyoming	5.94	5.94	100.00	100.00	105.94	105.94	94.4	94.4
Virgin Islands	27.41	27.41	27.41	27.41	54.82	54.82	50.0	50.0

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[a] Minnesota used only one rats in 1985.
[b] Texas used only one rate in 1986.
[c] Contributions vary by benefit plan and by county. State pays lesser of 90% of standard plan rate or 105% of lowest cost HMO in employee's county. Rates shown in table are for standard plan in Dane County (Madison).

Where two sets of figures are listed for a state, they represent the "low" and "high" basic plans.

retiree coverage, the state's share as of January 1986 varied as follows: 13 states paid 100 percent of the cost of coverage for a single retiree; six paid between 80 and 91 percent; two paid 50 percent and the remaining five paid less than half the total cost for a single retiree.

Among the 49 plans that make access to coverage available to retirees, the average cost of coverage for a single retiree 65 or over with Medicare was $52.36 for January 1986, or just 1.7 percent higher than the $51.47 average for January 1985. During the year ended January 1986, the average state share remained at approximately 49 percent of the average total cost for a single retiree.

Half the states, including Indiana and Nebraska, currently make no contributions toward the cost of retiree health care coverage. Over the next several years these states are likely to see much greater pressures from retirees to pay for part or all of the cost of their health care coverage. In some states, programs may also be established to start funding retirees' health care benefits on a level cost basis during the employees' working years.

Cost management initiatives

State employee health benefit plans utilize a variety of cost management techniques. Most state plans have added traditional types of cost management provisions, and some have instituted innovative nonconventional programs.

As part of the Segal Company's 1986 update of its survey of state employee health benefit plans, informative was obtained on the cost management steps that various states have put into effect. Among state plans, the major new development in the health care cost management arena is the adoption of precertification and preadmission review programs. In the past year alone, nearly one-third of all states incorporated such programs in their health benefit plans. Here is a brief overview of cost management initiatives recently implemented by state plans:

- **HMOs** — More than two-thirds

Table 2

Monthly Contributions to State Employee Health Insurance Plans: 1985 and 1986
Employee and Family Coverage

State	Cost to employee 1985	Cost to employee 1986	Cost to state 1985	Cost to state 1986	Total cost 1985	Total cost 1986	Percent of total cost paid by state 1985	Percent of total cost paid by state 1986
Alabama	82.50	82.50	100.00	105.00	182.50	187.50	54.8%	56.0%
Alaska	0	0	184.57	222.60	184.57	222.60	100.0	100.0
	0	0	234.84	237.75	234.84	237.75	100.0	100.0
Arizona	70.50	59.78	150.98	150.98	221.48	210.76	68.2	71.6
Arkansas	47.52	50.58	55.00	62.50	102.52	113.08	53.6	55.3
	73.08	77.54	55.00	62.50	128.08	140.04	42.9	44.6
California	39.20	8.67	209.00	211.00	248.20	219.67	84.2	96.1
	100.88	97.38	209.00	211.00	309.88	308.38	67.4	68.4
Colorado	121.00	117.12	53.12	57.00	174.12	174.12	30.5	32.7
Connecticut	42.26	44.56	183.18	193.34	225.44	237.90	81.3	81.3
Delaware	0	0	181.76	178.26	181.76	178.26	100.0	100.0
	46.80	45.90	181.76	178.26	228.56	224.16	79.5	79.5
Florida	55.64	55.64	122.80	122.80	178.44	178.44	68.8	68.8
Georgia	39.80	39.80	107.15	109.50	146.95	149.30	72.9	73.3
	66.00	66.00	107.15	109.50	173.15	175.50	61.9	62.4
Hawaii	53.36	56.03	80.04	84.05	133.40	140.08	60.0	60.0
Idaho	66.74	63.40	73.10	69.52	139.84	132.92	52.3	52.3
Illinois	67.18	67.18	98.56	96.32	165.74	163.50	59.5	58.9
	123.02	123.02	98.56	96.12	221.58	219.14	44.5	43.9
Indiana	36.66	36.66	178.01	178.01	214.67	214.67	82.9	82.9
Iowa	57.76	57.76	99.20	99.20	156.96	156.96	63.2	63.2
Kansas	137.19	127.39	83.42	78.53	220.61	205.92	37.8	38.1
Kentucky	80.92	83.94	53.82	60.22	134.74	144.16	39.9	41.8
Louisiana	90.96	90.96	90.96	90.96	181.92	181.92	50.0	50.0
Maine	48.58	52.46	119.66	129.46	168.24	181.92	71.1	71.2
Maryland	31.62	30.08	179.18	170.48	210.80	200.56	85.0	85.0
	56.46	53.78	179.18	170.48	235.64	224.26	76.0	76.0
Massachusetts	21.32	22.16	191.83	199.48	213.15	221.64	90.0	90.0
Michigan	31.16	31.16	280.52	280.52	311.68	311.68	90.0	90.0
Minnesota[a]	9.34	9.34	157.18	157.18	166.52	166.52	94.4	94.4
	—	25.82	—	157.18	—	183.00	—	85.9
Mississippi	89.70	89.70	58.80	72.00	148.50	161.70	39.6	44.5
Missouri	109.00	151.75	64.00	69.00	173.00	220.75	37.0	31.3
Montana	40.70	61.20	100.00	105.00	140.70	166.20	71.1	63.2
Nebraska	0	0	147.68	147.68	147.68	147.68	100.0	100.0
	42.58	39.95	159.23	159.23	201.81	199.18	78.9	79.9

of the states offer employees the option of participating in one or more health maintenance organizations. In several states HMOs have gone beyond the conventional and offer more benefits than the standard plan.

A number of states have recently augmented the use of HMOs. For example, Kentucky now offers 11 HMOs, and Illinois and Michigan allow employees to participate in 19 HMOs. South Carolina recently introduced HMOs on a statewide basis, and New Jersey added two for a total of 13. Wisconsin offers 24 HMOs in various geographic areas of the state, having added four effective January 1, 1986; about 60 percent of all active and retired Wisconsin employees currently participate in HMOs.

- **PPOs** — Preferred provider organizations, which have generated widespread interest in the private sector, are beginning to be implemented by the states. Two large states — Illinois and New York — recently established PPO networks and project that the new plans will result in substantial savings in health care costs. Alabama just established a network of preferred medical doctors and is considering creating a PPO for pharmacists. Oklahoma's new PPO option became available on January 1, 1986, and Tennessee recently began participating in a statewide hospital-based PPO.

Other states that have PPOs in place include California, Florida, Minnesota, Nevada, Pennsylvania and Utah. Utah's preferred provider arrangements with hospitals and surgical centers have been in effect for three years; the Utah PPO network was enlarged this year by adding new hospitals and clinics. For some preferred providers, Utah uses a draft system under which direct payments are made to the provider and no claim form is required on the part of the employee. Several additional states are currently evaluating the feasibility and potential cost savings that may result from

Table 2 **Employee and Family Coverage (Cont'd.)**

State	Cost to employee 1985	Cost to employee 1986	Cost to state 1985	Cost to state 1986	Total cost 1985	Total cost 1986	Percent of total cost paid by state 1985	Percent of total cost paid by state 1986
Nevada	87.16	69.73	124.20	129.20	211.36	198.93	58.8%	64.9%
New Hampshire	0	0	169.78	183.50	169.78	183.50	100.0	100.0
New Jersey	0	0	143.83	160.56	143.83	160.56	100.0	100.0
New Mexico	45.23	39.57	135.67	118.69	180.90	158.26	75.0	75.0
	72.36	63.31	108.54	94.95	180.90	158.26	60.0	60.0
New York	0	29.19	158.95	132.77	158.95	161.96	100.0	82.0
	35.46	34.53	162.11	163.33	197.57	197.86	82.1	82.5
North Carolina	77.23	89.54	48.05	63.82	125.28	153.36	38.4	41.6
North Dakota	0	0	140.00	168.00	140.00	168.00	100.0	100.0
Ohio	30.57	0	165.27	165.27	195.84	165.27	84.4	100.0
	61.13	61.13	165.27	165.27	226.40	226.40	73.0	73.0
Oklahoma	108.00	108.00	115.31	115.31	223.31	223.31	51.6	51.6
Oregon	0	0	126.39	130.41	126.39	130.41	100.0	100.0
—BUBB Plan	0	0	136.70	144.90	136.70	144.90	100.0	100.0
Pennsylvania	0	0	131.35	139.33	131.35	139.33	100.0	100.0
	0	0	179.36	189.81	179.36	189.81	100.0	100.0
Rhode Island	0	0	136.88	207.86	136.88	207.86	100.0	100.0
South Carolina	57.12	61.12	58.21	62.29	115.33	123.41	50.5	50.5
	67.38	72.10	58.21	62.29	125.59	134.39	46.3	46.4
South Dakota	122.36	130.74	50.72	53.42	173.08	184.16	29.3	29.0
Tennessee	50.09	29.22	116.89	116.89	166.98	146.11	70.0	80.0
Texas[b]	88.36	88.36	87.00	87.00	175.36	175.36	49.6	49.6
	144.48	—	87.00	—	231.48	—	37.6	—
Utah	21.82	21.82	196.39	196.39	218.21	218.21	90.0	90.0
Vermont	23.99	23.99	95.98	95.98	119.97	119.97	80.0	80.0
Virginia	48.30	52.52	118.48	128.60	166.78	181.12	71.0	71.0
Washington	0	0	183.56	183.56	183.56	183.56	100.0	100.0
West Virginia	0	0	187.95	187.95	187.95	187.95	100.0	100.0
Wisconsin[c]	19.33	26.00	173.93	181.89	193.26	207.89	90.0	87.5
Wyoming	111.42	111.42	100.00	100.00	211.42	211.42	47.3	47.3
Virgin Islands	74.68	74.68	27.41	27.41	102.09	102.09	26.8	26.8

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[a] Minnesota used only one rate in 1985.
[b] Texas used only one rate in 1986.
[c] Contributions vary by benefit plan and by county. State pays lesser of 90% of standard plan rate or 105% of lowest cost HMO in employee's county. Rates shown in table are for standard plan in Dane County (Madison).

Where two sets of figures are listed for a state, they represent the "low" and "high" basic plans.

establishing various types of PPO networks.

- **Second Opinions** — Second surgical opinion programs are now common features of state employee health benefit plans. Many of these programs include incentive features like 100 percent reimbursement or bonus payments, and a growing number require second opinions for specified surgical procedures.

State plans that provide 100 percent reimbursement for second opinions include Alaska, Arizona, Louisana, Mississippi, Missouri, New Mexico, Oregon, Pennsylvania and West Virginia. Utah not only pays 100 percent for second opinions but also pays an incentive bonus to the employee. Second opinions are now mandatory for selected surgeries in an increasing number of plans, including those in Arizona, Colorado, Nebraska, New Hampshire, Oklahoma, Virginia and Washington.

- **Outpatient Services** — Several states have recently amended their plans to provide incentives for outpatient surgery and for diagnostic and preadmission tests performed on an outpatient basis. During the past two years, almost one-fifth of the state plans have increased the reimbursement percentage to 100 percent for outpatient services. By contributing to the decrease in the use of hospital inpatient services, the outpatient incentives adopted by state plans have helped to reduce the overall rate of inflation in health care costs.

- **Precertification Programs** — Among state employee health benefit plans, the major new development in the area of health care cost management is the adoption of precertification programs. In 1986 alone, nearly one-third of the state plans instituted some type of precertification, preadmission review or case management program. States that added such programs include California, Colorado, Florida, Idaho, Illinois, Kansas, Kentucky, Michigan, Nebraska, North Carolina, North Dakota, Okla-

Table 3

Monthly Contributions to State Employee Health Insurance Plans: 1985 and 1986
Retiree Only Coverage (Over 65 with Medicare)

	Cost to retiree		Cost to state		Total cost		Percent of total cost paid by state	
State	**1985**	**1986**	**1985**	**1986**	**1985**	**1986**	**1985**	**1986**
Alabama	50.90	34.35	0	22.35	50.90	56.70	0 %	39.4%
Alaska	0	0	191.85	175.00	191.85	175.00	100.0	100.0
Arizona	67.68	67.68	0	0	67.68	67.68	0	0
Arkansas	37.50	41.50	0	0	37.50	41.50	0	0
California	0	0	67.51	51.70	67.51	51.70	100.0	100.0
	6.68	10.53	86.00	85.00	92.68	95.53	92.8	89.0
Colorado	0	0	48.12	48.12	48.12	48.12	100.0	100.0
Connecticut	26.59	25.59	21.76	20.94	48.35	46.53	45.0	45.0
Delaware	3.26	3.20	31.80	31.18	35.06	34.38	90.7	90.7
	21.78	21.36	31.80	31.18	53.58	52.54	59.4	59.3
Florida	55.30	55.30	0	0	55.30	55.30	0	0
Georgia	13.60	13.60	62.95	62.65	76.55	76.25	82.2	82.2
	26.65	26.65	62.95	62.65	89.60	89.30	70.3	70.2
Hawaii	0	0	51.08	53.64	51.08	53.64	100.0	100.0
Idaho	35.54	35.54	10.66	5.68	46.20	41.22	23.1	13.8
Illinois	0	0	77.56	75.24	77.56	75.24	100.0	100.0
Indiana	—	—	—	—	—	—	—	—
Iowa	31.90	31.90	0	0	31.90	31.90	0	0
Kansas	39.86	36.59	0	0	39.86	36.59	0	0
Kentucky	48.75	51.75	0	0	48.75	51.75	0	0
Louisiana	20.62	20.62	20.62	20.62	41.24	41.24	50.0	50.0
Maine	0	0	31.36	37.12	31.36	37.12	100.0	100.0
Maryland	9.02	7.90	51.16	44.76	60.18	52.66	85.0	85.0
	21.50	21.12	51.16	44.76	72.66	65.88	70.4	67.9
Massachusetts	6.63	6.65	59.64	59.86	66.27	66.51	90.0	90.0
Michigan	0	0	75.57	75.57	75.57	75.57	100.0	100.0
Minnesota	51.28	51.28	0	0	51.28	51.28	0	0
Mississippi	34.50	34.50	0	0	34.50	34.50	0	0
Missouri[a]	35.50	33.75	3.00	3.00	38.50	36.75	7.8	8.2
	—	60.00	—	3.00	—	63.00	—	4.8
Montana	49.00	61.00	0	0	49.00	61.00	0	0
Nebraska	—	—	—	—	—	—	—	—

homa, Tennessee, Virginia and Wyoming.

The specific provisions of precertification programs differ among the state plans. Some require precertification for all hospital admissions, while other plans mandate the precertification requirement only for certain types of admissions. In several states, including Colorado, Illinois, Kentucky, Nebraska, Oklahoma, Tennessee and Virginia, the precertification program encompasses additional features such as concurrent review, case management review, discharge planning and hospital length of stay assignments.

Although the cost effects of the various types of precertification programs are difficult to quantify, a number of states anticipate that the recent introduction of these programs will reduce the number of hospital admissions and considerably shorten average hospital stays for specified procedures.

- **Other Provisions** — Certain cost management provisions have been introduced by a few state plans and may become more widespread in the future. These include limitations on benefits for weekend admissions, providing benefits for services rendered by birthing centers, home health care benefits, hospice benefits and 100 percent reimbursement for generic drugs.

Although several states have considered adding benefits to promote good health, few currently provide so-called wellness benefits or incentives for healthier lifestyles. New York and Utah are two states that have instituted programs to promote good health. North Dakota adopted a new wellness program run by local health departments.

A few states have recently implemented new cost-effective plan designs that incorporate several cost management provisions. These plans have been introduced with the dual objectives of providing more cost-effective care and making employees cost conscious consumers of health care.

In conclusion, many states have been successful in holding down the costs of health benefit plans for their employees. From January 1985 to January 1986, the average cost of state employee health benefit plans increased by substantially less than national medical care costs as measured by the CPI. Because a state is often the largest employer within its own borders, it is clear that the cost management steps taken by state plans can influence providers and help make our health care system more cost effective. ☐

Table 3 **Retiree Only Coverage (Cont'd.)**

State	Cost to employee 1985	Cost to employee 1986	Cost to retiree 1985	Cost to retiree 1986	Total cost 1985	Total cost 1986	Percent of total cost paid by state 1985	Percent of total cost paid by state 1986
Nevada	61.68	56.89	29.81	34.81	91.49	91.70	32.6%	38.0%
New Hampshire	0	0	37.21	40.00	37.21	40.00	100.0	100.0
New Jersey[b]	43.71	45.00	0	0	43.71	45.00	0	0
New Mexico	46.50	46.50	0	0	46.50	46.50	0	0
New York[c,d]	9.28	9.07	83.57	81.59	92.85	90.66	90.0	90.0
North Carolina	0	0	36.32	48.58	36.32	48.58	100.0	100.0
North Dakota	44.00	50.00	0	0	44.00	50.00	0	0
Ohio	0	0	49.90	50.00	49.90	50.00	100.0	100.0
Oklahoma	45.90	45.90	0	0	45.90	45.90	0	0
Oregon	34.98	36.03	0	0	34.98	36.03	0	0
	43.78	43.78	0	0	43.78	43.78	0	0
Pennsylvania	0	0	43.75	57.78	43.75	57.78	100.0	100.0
	0	0	56.45	68.93	56.45	68.93	100.0	100.0
Rhode Island	34.60	41.37	0	0	34.60	41.37	0	0
South Carolina	0	0	50.50	54.04	50.50	54.04	100.0	100.0
South Dakota	49.22	51.92	0	0	49.22	51.92	0	0
Tennessee	33.96	33.96	0	0	33.96	33.96	0	0
Texas[e]	0	0	66.29	66.29	66.29	66.29	100.0	100.0
	0	—	85.02	—	85.02	—	100.0	—
Utah	49.50	54.50	0	0	49.50	54.50	0	0
Vermont	3.54	3.54	14.17	14.17	17.71	17.71	80.0	80.0
Virginia	30.96	37.16	0	0	30.96	37.16	0	0
Washington	38.86	38.86	0	0	38.86	38.86	0	0
West Virginia	23.95	23.97	0	0	23.95	23.97	0	0
Wisconsin[c,f]	51.43	57.15	0	0	51.43	57.15	0	0
Wyoming	44.12	44.12	0	0	44.12	44.12	0	0
Virgin Islands	21.19	21.19	21.18	21.18	42.37	42.37	50.0	50.0

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[a] Missouri used only one rate in 1985.
[b] State pays total cost for employees who retire with 25 or more years of credited service or retire on a disability pension.
[c] Sick leave credits may be used by retirees to pay premiums.
[d] State pays total cost for employees who retired before 1983.
[e] Texas used only one rate in 1986.
[d] Rates shown are for standard plan.

Where two sets of figures are listed for a state, they represent the "low" and "high" basic plans.

Teacher unions

Continued from page 40

trustee, NCTR Convention, Palm Beach, Florida, October 1, 1983.

7. *California Teachers Ass'n v. Cory,* 202 Cal. 3d 611-627 (1984).

8. In the two years following Thome's retirement, there were four different executive directors.

9. Interview with Mike Thome, executive director, California Teachers' Retirement System, at the NCTR Convention, Seattle, Washington, October 7, 1982.

10. This research has identified only the issues and how they have been influenced to some degree by politics. More study of the pension politics in this state could prove useful in defining the various forces.

11. Attached to the legislation was a nonseverability clause that said if the courts found any one part of the legislation unenforceable, the entire legislation would be inoperative.

12. *Pennsylvania Bulletin* 13, 45 (November 5, 1983): 3479-81.

13. Interview with Harvey Schmidt, executive director, Minnesota Educational Retirement Fund, meeting of National Conference of Public Employee Retirement Systems, San Antonio, Texas, April 12, 1983.

14. Interview with F. Michael Brennan, legislative director, Wisconsin Education Association, Madison, Wisconsin, January 5, 1983. Wisconsin's government relations director stated that while his teachers' system is financially sound and well funded, the benefits do lag behind those of several other states.

15. Interview with Richard Nichols, member, Washington Education Association, Phoenix, Arizona, November 4, 1983.

16. In an interview with R. H. Hollister, executive director, Washington State Retirement Systems, Seattle, Washington, October 8, 1982, he explained that he attempts to maintain good relations with the press and to be open and communicative about the system.

17. Interview with Richard Nichols.

18. One example of this is that for many years the position of executive director has been held by a former state senator.

19. National Education Association, *Estimates of Statistics,* Washington, D.C., numerous years; interview with John Sullivan, executive director, South Carolina Education Association, Columbia, South Carolina, March 25, 1983.

20. Without union opposition, the system went from a 4 percent employee and 8 percent employer contribution to a totally state contributory system, with a reduction from 2 percent per year defined benefit to 1.65 percent and Social Security. Only six thousand teachers continue in the old contributory system as of 1984.

21. Interview with Doug Mann, research director, Florida Retirement System, Tallahassee, Florida, March 28, 1983.

22. C. C. Elebash, "A New Strategy Strengthens Public Pension Fund Returns," *Florida Trend* (October 1982): 53.

23. Scott J. Paltrow, "Official's Disappearance, Loan Procedures Cloud Risky Investment by Teachers Fund," *Wall Street Journal* (August 17, 1983).

24. Interviews with various staff members of AEA and with other pension personnel, Phoenix, February 7 and 8, 1983, revealed that extensive reorganization of the AEA diminished the political involvement of staff. A subsequent interview with AEA members, New Orleans, November 10, 1985, revealed that the charges assessed the state and the employee for pension costs had been reduced for each from 7.00 percent of payroll, in effect from 1975 through 1983, to 6.27 percent in 1984 and 1985.

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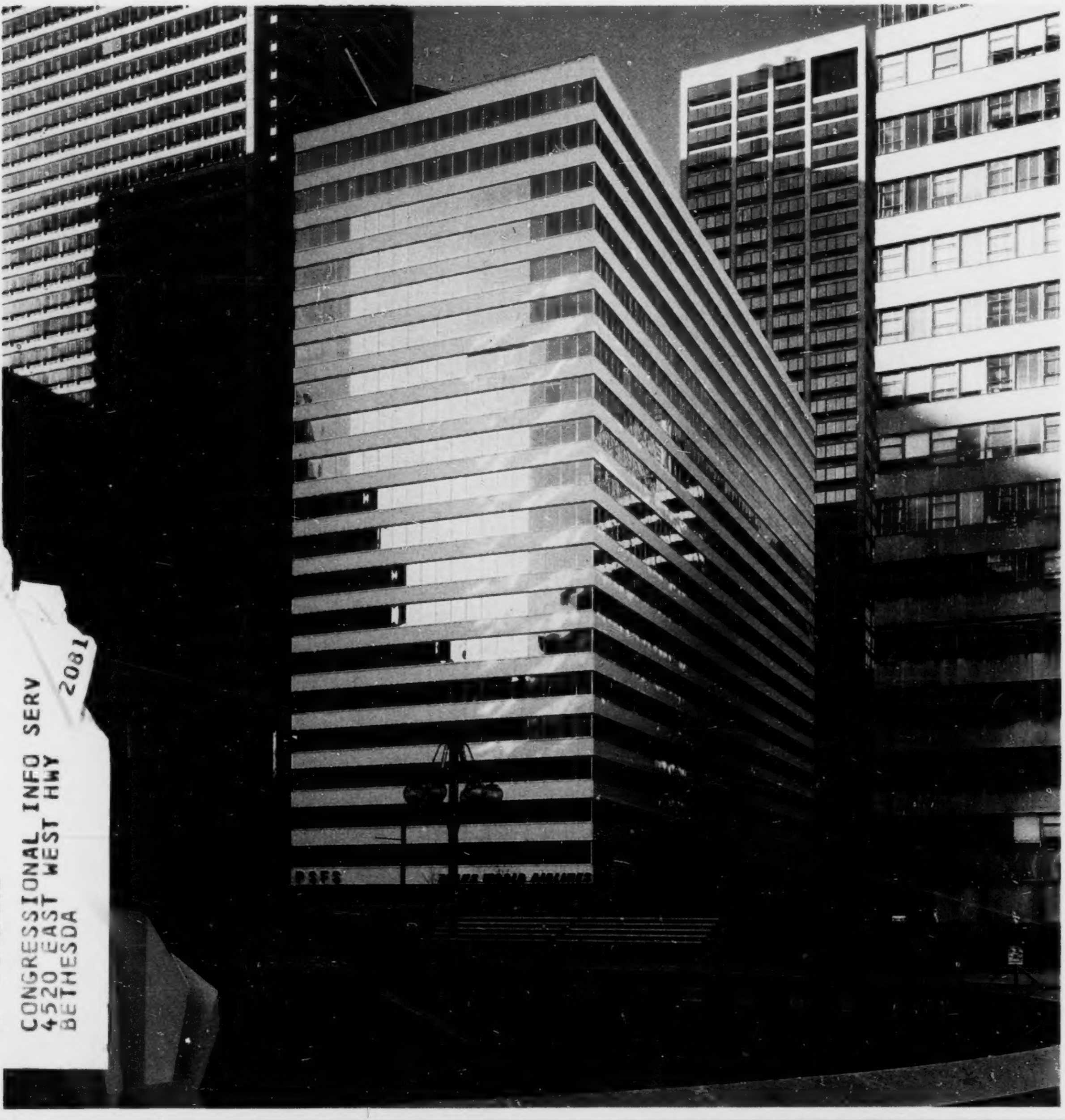

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New Looks Add Value to Older Buildings

Portfolio Insurance: Finding the Right Balance

1986 Real Estate Portfolio Manager Directory

Pension World

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Cover: **Three Penn Center at 1515 Market Street in Philadelphia was purchased by Richard Ellis, Inc., in 1984. It has been substantially upgraded since its acquisition. Photo by Tom Bernard; courtesy of Richard Ellis. Ronald Derven's profile of the firm begins on page 26.**

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BPA
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Agricultural investing: The contrarian strategy in real estate

Investing in farmland is not for everyone.

by **JAMES B. McCANDLESS**
Executive Vice President
Agrivest, Inc
Glastonbury, Conn.

Sometimes it seems the best way to deal with "ironclad" predictions of the crowd is to wait a few years. The crowd is bound to change its mind:

- **1979** "Inflation is here to stay."
- **1985** "Inflation is dead."

- **1974** "Common stocks will never recover."
- **1986** "The Dow-Jones Industrial Average is going to 2000."

- **1979** "Buy farmland."
- **1986** "Don't buy farmland."

Conventional wisdom always sounds like a good idea at the time, but no one ever succeeded by following the crowd. True, some axioms of conventional wisdom do make sense. For instance:

- "You never lose money selling at a profit,"
- "Buy low, sell high," and
- Don't put all your eggs in one basket."

For those who have heeded them, these time-tested bits of advice have yielded solid returns. The real question faced by the serious investor is:

Five Questions to Ask Before Investing in Agricultural Real Estate

Who should invest in agricultural real estate?
Anyone with patient capital, such as a pension plan, foundation, endowment or family trust. A six to eight percent cash-on-cash return, plus the opportunity for appreciation, is a reasonable expectation on investment-quality farm property.

What percentage of a portfolio should be invested in agriculture, and for how long?
For medium to large plans, one to five percent of a portfolio should be considered to diversify wisely in agriculture real estate. A minimum investment of $5 to $7 million and an optimum investment of between $15 to $20 million is generally required to achieve a well-diversified portfolio.

How is income generated?
The investor usually leases the property to a professional farm operator. In many cases, this is the original seller. The buyer and farm operator may then establish a fixed rent or share in operating costs for seed and fertilizer. These arrangements are established by local farm management companies that oversee operation of the property.

Where are the best locations to buy agricultural real estate?
Diversify by both area and crop. Buy only in prime areas of major producing states and avoid marginal land. Select a property that is a typical size for the area. Seek property selling at a 30 to 50 percent discount from 1981 peak prices. The land should be easily accessible and readily leased. Avoid land with buildings. Buildings mean maintenance and can become obsolete quickly.

What crops are best?
The lowest risk and volatility is with row crops of basic commodities. Vineyards, orchards and groves are more risky since trees and vines are subject to disease and storm damage. These types of properties can be more profitable and may be considered by buyers requiring the tax advantages of owning a depreciable agricultural asset.

> *"Everyone has heard the bad news about the agricultural economy, but few understand the situation that many landowners and landbuyers face . . . While attention is being focused on the problems of the American farmer, agricultural land holds opportunities for ground floor investment."*

Table 1 Growth of an Investment Dollar

	Farmland	Common Stocks	Long-term Corporate Bonds
1960	$ 1.00	$1.00	$1.00
1965	1.65	1.87	1.25
1970	2.56	1.87	1.21
1975	6.53	2.23	1.60
1980	13.97	5.30	1.85
1984	13.72	8.06	3.41

Table 2 Increases in Value During Inflationary Period

	Consumer Price Index	% Increase In Average Value Of Farmland
1977	6.8%	19.40%
1978	9.0	12.03
1979	13.3	18.27
1980	12.4	15.45

Table 3 Annualized Risk and Return, 1960-1984

	Volatility	Return
Agricultural Real Estate	7.88%	11.04%
Common Stocks	16.89	8.81
Commercial Real Estate	4.16	8.41
Corporate Bonds	9.63	5.35

Over the period, the average annual inflation rate was 5.24 percent with a volatility of 3.6 percent.

What does it take to identify good investment opportunities? Smart investors know that success depends on timing and relying on experts who understand the forces influencing the market.

Armchair economics

Today the crowd is advising the investor to stay away from agricultural real estate. However, the crowd has not been watching the forces that influence the agricultural real estate market. They look at agriculture from armchairs. As a result, they fail to recognize a sound opportunity.

Of course, everyone has heard the bad news about the agricultural economy, but few understand the situation that many landowners and landbuyers face. In many respects, agricultural investment mirrors commercial investment. Consider the position of the investor who bought an office building in Houston a few years ago. At that time, occupancy and rental rates justified the market price paid. The crowd was cheering. Then the Houston market fell out of bed. Vacancies increased, rents dropped and the oil business slipped into an economic depression. Given today's circumstances, the price the investor paid was too high.

Enter a new buyer. He pencils out a purchase price based on current economics, vacancies and rental rates that will produce a satisfactory return on investment. He makes his offer and buys the building. The crowd would say the new buyer is crazy. Not true. As far as the new buyer is concerned, he is banking on long-term vision and the economic cycle. He is getting in at the ground floor and, if the return is sufficient, then the crowd is crazy!

The knowledgeable investor sees that, while attention is being focused on the problems of the American farmer, agricultural land holds opportunities for ground floor investment. The key is to separate conventional wisdom from the economic forces affecting farmland values. Real estate investors who have taken a professional look at agriculture indicate the following factors as primary forces:

- **Income** — in terms of net income to farmers and rental income to landowners, farmland is an income-producing asset. As income rises and falls, so does the value of the asset that produces it.
- **Expectations of future earnings** — most landowners and farmers will bid up the price of farmland if they believe that future income levels will increase. This is similar to how common stock prices are bid in anticipation of the company's future earnings.
- **Supply and demand** — agricultural real estate is a finite resource. If many buyers are competing for property, they bid up the price of available land. If many sellers are trying to attract a buyer, they will discount the price of their land.

These fundamental forces should reach equilibrium, and this is when the market will bottom out. But this is not an efficient market because not everyone has the same information. Any investor waiting for the crowd to signal that it is okay to buy agricultural real estate will miss sound and profitable opportunities.

What other characteristics of agricultural real estate has the crowd overlooked?

Agricultural real estate is a long-term investment. Even with the declines experienced in the last few years, those who acquired farmland 15 and 20 years ago have an asset today that has yielded a very attractive return and continues to yield a competitive return on its purchase price.

From 1960 to 1984, every dollar invested in farmland would have grown 41 percent more than a dollar invested in common stock and 75 percent more than long-term corporate bonds, according to Ibbotson Associates, an economic and financial consulting firm founded by Roger Ibbotson, professor of finance at Yale School of Management. Table 1 illustrates these findings.

Inflation hedge

Agricultural real estate values are highly correlated with inflation. Ibbotson Associates' 24-year data indicate a correlation of 0.93 for farmland compared to the inflation rate. Since the present rate of inflation is quite low, it's not surprising that farmland values are not increasing. However, in those years of high inflation, farmland yielded attractive "real" returns above the inflation rate, as shown in Table 2.

When farmland prices were falling, the stock market was booming. When farmland prices were booming in the mid-'70s, commercial real estate was in the doldrums. Ibbotson Associates data indicate that farmland is negatively correlated with common stocks and corporate bonds, but it is independently correlated with commercial real estate. Agricultural assets can diversify a portfolio against shifts in the common stock and the bond markets, as well as geographically (by location in the United States) and by individual crop.

Risk is measured by most investors by the volatility of the rate of return on the asset. Most portfolio managers seek investments that dampen instability of the common stock portion of their portfolio. The fluctuation of the total return on farmland is substantially lower than that of common stocks. While low risk is desirable, it is difficult to find assets that also have proven high returns and low risk. Table 3 illustrates that agriculture over the past 24 years was less risky and the returns were over two percent higher than with common stocks.

Aside from investment portfolio decisions, land values will be influenced by a number of domestic and international factors. Since we consume about 70 percent of what we produce and sell the other 30 percent overseas, recovery of the agricultural sector depends heavily on international trade. Any movement of U.S. interest rates and the dollar's exchange value will affect U.S. agriculture competitiveness in world food and fiber markets. Presently, many trends and governmental decisions bode well for American farmers trying to meet foreign competition.

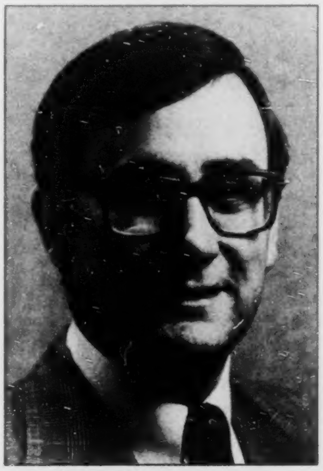
The current adjustment in farmland prices has resulted in a substantial reduction in costs since land is the major cost component of crop production. Lower interest rates have also contributed to cost reductions. Furthermore fuel, oil and gas price reductions have helped to reduce the cost of equipment operations and fertilizer costs.

A weaker dollar is of considerable help in increasing our exports, but it is not the only answer. Lower federal deficits and the lower interest rates that follow will help as well. Stronger growth in the global economy will result in a greater demand for food by Third World nations.

Most observers believe 1986 will not bring much change. Land prices may continue to slip as lower income levels and financial stress hurt farmers. However, most agree that the worst is over, all the bad news is past and the land markets have already responded.

Conclusion

The factors that influence farmland values, income, income expectations and supply and demand have all contributed to opening the window of opportunity for the investor today. Farmland markets have already absorbed the adverse news in the agricultural economy. While no one can predict the day we turn the corner, there are some positive signs on the horizon. Among them are lower interest rates, the relative value of the dollar and global prosperity and economic growth. Agricultural real estate is one of our most basic assets and an investment that the prudent long-term investor should seriously consider. ☐



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Current Issues In Plan Design

How does an employer handle a COBRA? Very carefully!

Congress has loosed a deadly snake to prey upon employers across the land. COBRA—the Consolidated Omnibus Budget Reconciliation Act—has as its overall objective a reduction in federal spending. This year, Congress included in the Act a number of provisions of special concern to employers, including mandatory provisions for health care continuation coverage.

COBRA requires employers to offer health care benefits to those who would otherwise become ineligible for group coverage: employees who terminate or work reduced hours; surviving, divorced or separated spouses and their dependents; and dependent children who reach the limiting age. Employers may charge "continuees" the "full" cost of the coverage. That sounds easy enough. Employers can fulfill a social need at no company cost.

But beware! COBRA's implications are so broad that, like its slithery namesake, this legislation can surprise even the most expert handler. And those who err may feel its bite.

Employers who fail to comply with COBRA will lose their tax deduction for all group health plan expenses and their highly compensated employees (generally the highest paid 25 percent) will have to include the value of health coverage in their gross income. In addition, plan administrators may be fined up to $100 a day for failure to meet notification requirements. Neither employers' insurance carriers nor their health maintenance organizations (HMOs) are required to provide continuation coverage for employers who fail to provide such coverage. The burden falls on employers and plan administrators.

COBRA requirements are effective for health plan years beginning on or after July 1, 1986, except for plans subject to collective bargaining. For these, the requirements will be effective for plan years beginning after the last plan-related collective bargaining agreement terminates, or January 1, 1987, whichever is later.

Because regulations governing compliance will take time to develop, Congress encouraged employers "to operate in good faith compliance with a reasonable interpretation" of the law. But the law leaves a morass of unresolved issues and employers will have considerable flexibility in their compliance strategy. Furthermore, the law departs from past practice in providing that regulations will *not* be effective retroactively. Later, employers may have to change their strategy to comply with specific regulations, but they should not be at risk for initial compliance strategies based upon a reasonable interpretation of the law.

Yes; no; well, maybe

COBRA's continuation coverage provisions are summarized in Table 1, COBRA Basics. They appear to be relatively simple, but they raise a host of unanswered questions. For example, the legislative history indicates that continuees be permitted to "... modify coverage at the same time and in the same manner as other similarly situated beneficiaries." Does that mean that an employee who has coverage under a high-option medical plan can elect coverage as a continuee under a low-option plan at annual reenrollment? Last May, TPF&C asked employers if they would allow "qualified beneficiaries" to elect a different indemnity plan option. Of 112 respondents who offer multiple options, 30 percent said they would allow qualified beneficiaries to make changes in the same manner as active employees; 54 percent did not yet know what they would do. (Other results are shown in Table 2, Employer Survey Highlights.)

HMO/indemnity plan transfers pose even more difficult questions. If an employee belongs to an HMO and terminates, can he or she purchase continuation coverage under the employer indemnity plan at regular open enrollment? At termination? Of 171 survey respondents who have HMOs, only 29 percent said they would allow HMO members to purchase continuation coverage under an indemnity plan at open enrollment; another nine percent would allow such a change anytime after the "qualifying event." TPF&C also surveyed 14 insurance carriers last May. Only three said they would permit an HMO member to purchase continuation coverage under an employer indemnity plan. (Results are shown in Table 3, Insurance Carrier Survey Highlights.)

Under COBRA, however, continuees retain their right to modify coverage on the same basis as other employees and their dependents. Therefore, regulations may require employers to allow continuees to move from HMOs to indemnity plans (or vice versa) at open enroll-

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Table 1 COBRA Basics

Effective date. Plan years beginning after June 30, 1986 except for collective bargaining agreements, which will be subject to COBRA the later of January 1, 1987, or the plan year beginning after the last plan-related collective bargaining agreement terminates.

Qualified beneficiary. An employee or dependent who becomes ineligible for group coverage due to a qualifying event.

Qualifying event. Employment termination or reduction in work hours; employee death, divorce or legal separation; employee entitlement to Medicare benefits; dependent child reaching the limiting age.

Limiting age. The age, usually 19 or 23, at which a dependent child is no longer eligible for group coverage as a dependent child.

Similarly situated beneficiary. Covered employee or dependent who has not experienced a qualifying event.

Notice requirements. Employers have 30 days to notify plan administrators that an employee has died, terminated or is working reduced hours; after receiving notice that a qualifying event has occurred, plan administrators have 14 days to notify qualified beneficiaries of their continuation rights.

Election period. The period during which the qualified beneficiary can make his/her continuation coverage election; starts no later than the date (1) group coverage normally would terminate or (2) the qualified beneficiary receives notice of the right to elect; lasts for at least 60 days.

Maximum coverage period. 18 months for an employee who terminates or works reduced hours (and his or her dependent); 36 months for all others.

Premium. Up to 102 percent of the actual or estimated per capita cost for similarly situated beneficiaries.

Penalties. Lose corporate tax deduction for all group health plan expenses; include value of health plan coverage in income of highly compensated employees; ERISA penalties.

ment. If an HMO does not offer continuation coverage, an employer may have to make coverage available through the indemnity plan when a qualifying event occurs.

And there are other unanswered questions. For example, how will employers who have flexible benefit plans respond to an employee who waives medical coverage under the flex plan, then terminates and wants to elect continuation coverage? What does the law intend? Is it reasonable to deny coverage until regulations are issued? What if a continuee marries or has a child? Is the new dependent eligible for coverage? Maybe—continuees can modify coverage—but the law also says that a qualified beneficiary is an individual who was covered under the plan "the day before the qualifying event."

How much can an employer charge for continuation coverage? Continuees cannot be required to contribute more than 102 percent of the cost of providing coverage for "similarly situated beneficiaries." That seems simple enough, but how is the cost—COBRA calls it the "applicable premium"—to be calculated? The law provides some guidance:

- Under an insured arrangement, the applicable premium is assumed to be the per capita premium the insurance carrier charges.
- A self-insured employer has two options. The employer can estimate the cost of coverage for the same 12-month period for active employees, or use the cost of coverage for the previous year, adjusted by the GNP price deflator. (This method can only be used if there have been no significant changes in the work force or plan design.)
- The applicable premium can be adjusted for coverage (e.g., high vs. low option and single vs. family) and location.

COBRA's cost-of-coverage guidelines appear to be relatively straightforward. But are they really? Can employers age-rate continuation coverage premiums? The answer seems to be yes. Although this approach might be more equitable, it would probably reduce the total amount of contributions because younger qualified beneficiaries, with their lower average costs, would find the plan more attractive than would older beneficiaries with higher average costs.

The law allows employers to adjust continuation coverage premiums for family status. But could an employer who has a contributory indemnity plan for active employees with a three-tier contribution structure (i.e., single employee; employee and spouse; employee, spouse and children) charge a composite continuation coverage premium? In that event, single continuees would be subsidizing those with families. If an employer has high turnover among young, short-service employees and wants them to bear an appropriate share of the expense of continuation coverage, this might be a good strategy because it would make continuation coverage relatively more expensive for the young, short-service group. Of the 198 employers TPF&C surveyed, 21 percent plan to charge a uniform premium, 35 percent will adjust rates and 38 percent do not know how they will calculate premiums.

COBRA also apparently allows employers to charge continuees *less* than 102 percent. Could an employer therefore charge the full amount for former employees who elect continuation coverage but less for other qualified beneficiaries? Might an employer want to provide free coverage to surviving spouses? Would an employer who wants to help older dependent children get advanced degrees require only a modest contribution—say, 25 percent—for dependent children who reach the limiting age? Because COBRA is silent on this issue, employers are bound only by good reason.

Suppose an employer sees a 23-year-old dependent as an adult who should be supporting himself and bristles at offering that "child" continuation coverage. Could such an employer reduce the limiting age to 20? In effect, the before-COBRA coverage would be maintained if the employer paid the continuation coverage premiums until age 23. But is this "good faith compliance?"

Can an employer subsidize certain continuee options? Is it lawful to encourage continuees to join HMOs by subsidizing their membership? For example, continuees might have to pay 102 percent to purchase coverage under the employer indemnity plan but only 50 percent to belong to an HMO. This strategy would give the employer a strong advantage in that the HMO would assume the full financial risk. There appears to be nothing in COBRA that would disallow such an approach. HMOs might be reluctant to accept members on that basis, however.

If favoring HMO membership through greater employer subsidy is defensible, could an employer offer continuees a choice between paying 102 percent for coverage under the standard employer indemnity plan but only half that amount for coverage under a separate, scaled-down, continuees-only plan? Does this strategy violate the requirement that continuees be offered "coverage identical to the coverage provided under the plan to similarly situated beneficiaries?" Continuees can elect to have the same coverage as active employees and their dependents. Does that stay within the cost-of-coverage guidelines? Is it, therefore, reasonable?

What we know

In addition to dealing with the issues on which COBRA is silent, employers may find that complying with explicit requirements is a complex task for which they are ill-prepared. Tracking continuee eligibility and communications, billing and premium collection are new tasks for many employers. They will have to develop systems and procedures and assign and train staff.

Table 2 Employer Survey Highlights (Based on 198 Respondents)

Of the employers surveyed by TPF&C on COBRA premium calculations:
- 21 percent will charge all continuees the same rate;
- 35 percent will adjust rates (family status and location are the most common adjustments);
- 38 percent have not decided how they will determine rates.

An overwhelming majority of employers expect to handle COBRA administration. Although only 33 percent of respondents are self-administered:
- 98 percent will send election forms to qualified beneficiaries;
- 69 percent will handle billing (22 percent say continuees will not get bills);
- 93 percent will collect premiums.

Fifty-two percent of respondents have not decided when they will allow qualified beneficiaries to change family status.
- 29 percent will permit changes at the same time as for employees;
- 15 percent will permit changes anytime after a qualifying event.

Sixty percent of companies that offer HMOs do not know if continuation coverage will be available through the HMOs; 32 percent report that their HMOs will offer such coverage. If an HMO member who becomes a qualified beneficiary wants to join the employer indemnity plan:
- Nine percent of employers who offer HMOs will allow such a change anytime after a qualifying event;
- 29 percent will allow such a change at the same time as employees;
- 58 percent are not sure what they will allow.

Fifty percent of self-insured employers plan to continue offering conversion options; 46 percent are undecided.

Although some employers are looking to their insurers/plan administrators to assist with these tasks, some may be unable to get help. Only three of the 14 carriers TPF&C surveyed responded that they would offer billing and premium collection services. At least at first, most employers are planning to handle administration internally. Of the 198 employers who responded to TPF&C's May survey, 97 percent will send election forms to qualified beneficiaries. Even though only one-third of the respondents have self-administered plans, 69 percent will handle billing. (Another 22 percent say continuees will not get bills.) And 92 percent will collect premiums.

Carriers are off the hook—for now. But employers may soon *demand* administrative assistance and carriers will have to respond. Even now, a few carriers are preparing to offer COBRA services. Since none of those surveyed intends to offer any kind of freestanding COBRA product, most employers will have to look to existing insurers/administrators for help.

Administrative structures

Many employers have separate medical, dental, prescription drug and/or vision plans, some of which may have different plan years. The plans may also be administered by different organizations. Obviously, COBRA compliance could be an administrative nightmare for these employers. For example, if an employer's medical plan year begins June 1 and its dental plan year begins October 1, does the employer have to offer just dental continuation coverage until COBRA applies to the medical plan on June 1, 1987? Alternatively, could the sponsor offer no continuation coverage until June 1, 1987? If these same plans are administered by different insurance carriers, how would notification, recordkeeping and billing be affected? Would the employer have to comply with COBRA for each plan separately? Would one of the administrators provide COBRA administrative services for both plans?

To complicate COBRA compliance even further, suppose an employer has 12 divisions and its benefit plan administration function is decentralized. If one division fails to comply, the entire company will be subject to COBRA sanctions. Ensuring that all units are in compliance might be as difficult as steering a group of tourists through a snake pit.

COBRA's provisions regarding proper notification deadlines are fairly straightforward. There is, however, one glaring omission. In the event of divorce, legal separation or reaching the limiting age, COBRA does not specify how long the qualified beneficiary has to notify the employer/administrator that a qualifying event has occurred. This could result in serious adverse selection. If a dependent, a daughter, say, reached age 23—the limiting age—she could choose not to notify the employer/administrator of her status until she incurs medical expenses. In effect, no premiums would be paid until a claim is incurred. If she were very clever, she could elect to give notice only if her expenses exceeded the total continuation coverage premiums—an actuary's worst adverse selection nightmare.

Employee communication requirements are more vague than those that pertain to notification deadlines. COBRA says, for example, that the summary plan description must include notice of continuation coverage. In addition, a health plan administrator must send written notice to the qualified beneficiary's last known address within 14 days after the administrator has been notified that a qualifying event has occurred. Posting notice regarding the availability of continuation coverage on a bulletin board is insufficient. In June, however, the Department of Labor issued safe-harbor notification language. Employers who use this language will be considered to have properly complied with the notification provision of the law.

Regulations will define communication requirements in more detail. Until they are issued, what guidelines should employers use? Insufficient and inconsistent employee communications have become serious stumbling blocks for employers with respect to retiree medical benefits. The courts' message is, when in doubt, be specific and consistent in both written and verbal communications. Employers would be well-advised to apply this wisdom to COBRA—specifically, to reserve the right to amend and terminate coverage.

What's ahead

As employer health care cost management efforts and the Medicare Prospective Payment System exert financial pressure upon hospitals, paying for care provided to the uninsured has become a difficult problem. Moreover, in this age of the $200 billion federal deficit, Congress is eager to shift responsibility to employers for providing health care benefits to as many people as possible. It is worth noting that with the passage of COBRA, Congress has for the first time enacted broad group benefit plan *coverage* requirements. Historically, mandated coverage has been regulated by state law.

Against this backdrop, employers should expect more legislation in the future. In fact, another bill, the Access to Health Care Act, introduced in Congress last May, would require employers to extend coverage to laid-off workers for up to four months at the same required contribution level as active employees. In addition, the new nondiscrimination rules contained in tax reform legislation will cause employers to provide health care benefits to a larger employee group. Surely, more legislation will follow COBRA. Employers can only hope it will not have as bad a bite. ☐

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Table 3
Insurance Carrier Survey Highlights
(Based on 14 Respondents)

	Yes	No	Not Sure
Will continuation coverage be funded as other employer coverage?	14	0	0
Will you bill and collect continuation coverage premiums?	3	6	5
Will procedures to certify continued eligibility be different from those used for actives?	0	14	0
Would you be reluctant to allow HMO members to purchase continuation coverage under the employer indemnity plan at open enrollment?	3	5	6
Will your computer systems and software be ready to handle continuation coverage on July 1?	12	1	1
Do you intend to market a separate continuation coverage product?	0	7	7
Will you advise employers to discontinue conversion privileges where not required by law?	0	14	0